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R2017-0210/1

September 11, 2017

Closing Date: Thursday, September 28, 2017 at 6 p.m.

FROM: Vice President and Corporate Secretary

Belarus - Micro, Small and Medium Enterprise (MSME) Access to Finance Project

Project Appraisal Document

Attached is the Project Appraisal Document regarding a proposed loan to the Development Bank of the Republic of Belarus (DBRB) with a sovereign guarantee from Belarus for a Micro, Small and Medium Enterprise (MSME) Access to Finance Project (R2017-0210), which is being processed on an absence-of-objection basis.

Distribution:
Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC and MIGA

Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No: PAD1219

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT ON A

PROPOSED LOAN

IN THE AMOUNT OF US$60 MILLION

TO THE

JOINT STOCK COMPANY “DEVELOPMENT BANK OF THE REPUBLIC OF BELARUS”

WITH A GUARANTEE OF THE REPUBLIC OF BELARUS

FOR A

MICRO, SMALL AND MEDIUM ENTERPRISE ACCESS TO FINANCE PROJECT
(P152276)

September 7, 2017

Finance and Markets Global Practice
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of May 16, 2017)

Currency Unit	=	Belarusian Ruble (BYN)
BYN1.8599	=	US$1
US$1.37	=	SDR1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

CPS	Country Partnership Strategy
DBRB	Development Bank of the Republic of Belarus
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
EMF	Environmental Management Framework
EMP	Environmental Management Plan
EU	European Union
FSAP	Financial Sector Assessment Program
GoB	Government of the Republic of Belarus
GDL	Government Directed Lending
GDP	Gross Domestic Product
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
ICB	International Competitive Bidding
ICT	Information and Communication Technology
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IMF	International Monetary Fund
IPF	Investment Project Finance
IT	Information Technology
LoC	Line of Credit
MIS	Management Information System
MoE	Ministry of Economy
MoF	Ministry of Finance
MSME	Micro, Small, and Medium Enterprise
M&E	Monitoring and Evaluation
NBRB	National Bank of the Republic of Belarus
NPL	Nonperforming Loan
OECD	Organization for Economic Co-operation and Development
OP/BP	World Bank Operational Policy/Bank Procedure
PDO	Project Development Objective
PFI	Participating Financial Institution

PIU	Project Implementation Unit
POM	Project Operations Manual
PPP	Public-Private Partnership
SBD	Standard Bidding Document
SDR	Special Drawing Rights
SFA	Subsidiary Financing Agreements
SME	Small and Medium Sized Enterprise
SOE	State-Owned Enterprise
STEP	Systemic Tracking of Exchanges in Procurement System
TA	Technical Assistance
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WB/WBG	World Bank/World Bank Group

Regional Vice President:	Cyril Muller
Country Director:	Satu Kahkonen
Senior Global Practice Director:	Ceyla Pazarbasioglu-Dutz
Practice Manager:	Mario Guadamillas
Task Team Leader:	Johanna Jaeger

BELARUS
MSME ACCESS TO FINANCE PROJECT (P152276)

TABLE OF CONTENTS

Page

.

PAD DATA SHEET

Belarus

Belarus MSME Access to Finance Project (P152276)

PROJECT APPRAISAL DOCUMENT

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EUROPE AND CENTRAL ASIA

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Report No.: PAD1219

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Basic Information

Project ID P152276	EA Category B - Partial Assessment	Team Leader(s) Johanna Jaeger
Financing Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]	
	Financial Intermediaries [X]	
	Series of Projects [ ]	
Project Implementation Start Date 31-Dec-2017	Project Implementation End Date 29-Jul-2022	
Expected Effectiveness Date 31-Dec-2017	Expected Closing Date 31-Dec-2022	
Joint IFC No		

Practice Manager/Manager	Senior Global Practice Director	Country Director	Regional Vice President
Mario Guadamillas	Ceyla Pazarbasioglu-Dutz	Satu Kristiina J. Kahkonen	Cyril E Muller

Borrower: Development Bank of the Republic of Belarus			
Responsible Agency: Development Bank of the Republic of Belarus			
Contact:	Artem Koptev	Title:	Head of Financial Institutions
Telephone No.:	+375172391128	Email:	koptev.a@brrb.by

Project Financing Data(in USD Million)

[X]	Loan	[ ]	IDA Grant	[ ]	Guarantee

[ ] Credit	[ ] Grant	[ ] Other

Total Project Cost:	60.00	Total Bank Financing:	60.00
Financing Gap:	0.00		

Financing Source	**Amount**
Borrower	0.00
International Bank for Reconstruction and Development	60.00
Total	60.00

Expected Disbursements (in USD Million)

Fiscal Year	2018	2019	2020	2021	2022	2023	0000	0000	0000	0000
Annual	10.00	15.00	20.00	10.00	5.00	0.00	0.00	0.00	0.00	0.00
Cumulative	10.00	25.00	45.00	55.00	60.00	0.00	0.00	0.00	0.00	0.00

Institutional Data

Practice Area (Lead)

Finance & Markets

Contributing Practice Areas

Trade & Competitiveness

Proposed Development Objective(s)

The Project Development Objective (PDO) is to improve access to finance for private MSMEs and enhance governance and the institutional capacity of the Development Bank of the Republic of Belarus.

Components

Component Name	**Cost (USD Millions)**
Component I: Line of Credit to MSMEs	56.20
Component II: Institutional Strengthening of DBRB	3.25
Component III: Project Management and Implementation	0.55

Systematic Operations Risk- Rating Tool (SORT)

Risk Category	**Rating**
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial

7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	
OVERALL	Substantial

Compliance

Policy		
Does the project depart from the CAS in content or in other significant respects?	Yes [ ]	No [X]
Does the project require any waivers of Bank policies?	Yes [ ]	No [X]
Have these been approved by Bank management?	Yes [ ]	No [X]
Is approval for any policy waiver sought from the Board?	Yes [ ]	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No [ ]

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01	**X**	
Natural Habitats OP/BP 4.04		**X**
Forests OP/BP 4.36		**X**
Pest Management OP 4.09		**X**
Physical Cultural Resources OP/BP 4.11		**X**
Indigenous Peoples OP/BP 4.10		**X**
Involuntary Resettlement OP/BP 4.12		**X**
Safety of Dams OP/BP 4.37		**X**
Projects on International Waterways OP/BP 7.50		**X**
Projects in Disputed Areas OP/BP 7.60		**X**

Legal Covenants

Name	**Recurrent**	**Due Date**	**Frequency**
PFI on-lending to MSMEs	**X**		CONTINUOUS

Description of Covenant

PFI on-lending to MSMEs shall be made only in accordance with the Eligibility Criteria, Terms and Conditions listed in Loan Agreement.

Name	**Recurrent**	**Due Date**	**Frequency**
Sub-financing to MSMEs	**X**		CONTINUOUS

Description of Covenant

Sub-financing to SMEs shall be made only in accordance with the Eligibility Criteria, Terms, Conditions and Approval Procedures listed in Loan Agreement.

Conditions		
Source Of Fund	**Name**	**Type**
IBRD	Project Operations Manual	Effectiveness
Description of Condition		
The Borrower shall have adopted the Project Operations Manual satisfactory to the Bank.		
Source Of Fund	**Name**	**Type**
IBRD	Subsidiary Financing Agreement	Effectiveness
Description of Condition		
The Subsidiary Financing Agreement has been executed on behalf of the Borrower with at least two Eligible PFIs.		
Source Of Fund	**Name**	**Type**
IBRD	Project Implementation Unit (PIU)	Effectiveness
Description of Condition		
The Borrower shall establish a PIU with the composition, terms of references and resources satisfactory to the Bank.		

Team Composition

Bank Staff

Name	Role	Title	Specialization	Unit
Johanna Jaeger	Team Leader (ADM Responsible)	Senior Financial Sector Specialist	Senior Financial Sector Specialist	GFM03
Alexander Pankov	Team Member	Lead Financial Sector Specialist	Lead Financial Sector Specialist	GFM03
Kiryl Haiduk	Team Member	Economist	Economist	GMF12
Elena Klochan	Team Member	Sr Country Program Officer	Sr Country Program Officer	ECCBY
Esma Kreso	Safeguards Specialist	Senior Environmental Specialist	Senior Environmental Specialist	GEN03
Luis M. Schwarz	Team Member	Senior Finance Officer	Senior Finance Officer	WFALN
Nikolai Soubbotin	Team Member	Lead Counsel	Lead Counsel	LEGLE
Aimonchok Tashieva	Team Member	Social Development Specialist, Safeguard Policies	Social Development Specialist	GSU03
Moses Sabuni Wasike	Financial Management Specialist	Sr Financial Management Specialist	Senior Financial Management Specialist	GGO21

Alexander Balakov	Procurement Specialist (ADM Responsible)	Senior Procurement Specialist	Procurement Specialist	GGO03
Barbara Ziolkowska	Procurement Specialist	Procurement Specialist	Procurement Specialist	GGO03
Jennifer Shkabatur	Team Member	Consultant	Safeguards Specialist	GSU03
Irina Oleinik	Team Member	Operations Officer	Operations Officer	ECCBY
Olga Sherbina	Team Member	Operations Officer	Operations Officer	CEUAS
Alina Gres	Team Member	Executive Assistant	Executive Assistant	ECCBY
Anne Muuna Kisumo	Team Member	Program Assistant	Program Assistant	GFM03
Hanna Shvanok	Team Member	Team Assistant	Team Assistant	ECCBY

Extended Team

Name	Title	Office Phone	Location
Andrei Smolski	Consultant	375173591992	
Natalia Konovalenko	Financial Management Consultant	380444906671	
Nataliya Strandako	Safeguards Consultant	00380501726333	
Oskana Rakovych	Environmental Safeguards Consultant	380444906671	

Locations

Country	First Administrative Division	Location	Planned	Actual	Comments

I. STRATEGIC CONTEXT

A. Country Context

1. **In recent years, an unfavorable external environment overshadowed economic activity in Belarus, but significant progress was made on macroeconomic stabilization**. Recession in Russia and low commodity prices have had a major downward impact on Belarus's economy which contracted by 3.8 percent in 2015, the first recession in two decades. This is largely explained by Belarus's dependency on the Russian market[1] and on mineral exports[2]. Real gross domestic product (GDP) continued to contract in 2016, albeit at a slower pace, by 2.6 percent y/y, due to lower export revenues and weak domestic demand. In addition, a dispute with Russia on the price of natural gas imports resulted in a 25 percent reduction in crude oil supplied by Russia to Belarusian refineries. In the face of difficult external conditions and domestic structural rigidities, a considerable reduction in aggregate expenditures has occurred. The magnitude of the adjustment is visible in the decline in the current account deficit from US$5.2 billion in 2014 to US$1.7 billion (about 3.6 percent of GDP) in 2016, mainly due to compression of imports. This adjustment was accompanied by tighter fiscal and monetary policies during 2015-2016. In particular, capital expenditures and real wages in the public sector have been reduced dramatically. In 2016, broad money supply decreased in real terms, while credit supply shrank by 10 percent in real terms. The economy has started stabilizing in Q1 2017, with mild and yet tentative recovery supported by growth in agriculture and manufacturing sectors.

2. **Accumulated imbalances weaken Belarus's growth potential and call for a transition from a state-driven to a market-based economic model**. The role of the state in the Belarusian economy has been significant in the productive (with 50-percent share in gross value added) and financial (with two state-owned banks owning 66 percent of banking system assets) sectors. State-owned banks and enterprises have been closely connected as the former provided subsidized loans to the latter. The share of subsidized lending in the total stock of loans exceeded 40 percent, or about 18 percent of 2015 GDP. Widespread use of preferential loans has distorted the operation of the financial system by splitting it into subsidized and non-subsidized parts, mirroring the similar division in the real sector. In certain cases, capital stock accumulation by beneficiary SOEs resulted in unproductive allocation of capital economy-wide, as they failed to increase revenues and productivity. At the same time, higher real interest rates for non-privileged borrowers have discouraged private investment and diminished the capacity of private firms to expand their production and create jobs.

3. **In the medium term, economic recovery is expected to remain weak as structural bottlenecks persist and domestic demand remains subdued.** GDP is projected to decline by 0.4 percent in 2017, followed by modest growth of 0.7 percent in 2018, and 1.2 percent in 2019. Recovery in the manufacturing sector is expected to be supported by gradual improvements in external demand, although structural bottlenecks continue to undermine competitiveness. However, domestic demand will remain constrained by low investment and low income growth. In order to escape this low growth trap, productivity increases are required. To restore growth,

[1] 57 percent of Belarus's merchandize exports.

[2] close to one-fourth of goods and services exports.

distortive state interventions need to be reduced, and companies in the public sector have to operate more efficiently to enhance productivity and profitability. More enabling policies for the development of the private sector – including through improved access to finance – can help to raise productivity and stimulate employment growth in the Belarusian economy.

B. Sectoral and Institutional Context

4. **The financial system has a high degree of government involvement and is dominated by banks.** The majority of the financial sector comprises commercial banks, which constitute about 84 percent of assets, equivalent to 73 percent of GDP. The remainder of the assets is shared among the Development Bank of the Republic of Belarus (DBRB, 7 percent), the insurance sector (3 percent), and leasing and microcredit companies (slightly more than 5 percent). Within the banking sector, the largest 10 banks make up most of the banking system. Of these, the top five as well as two foreign banks are part of conglomerates. Nearly 65 percent of total assets are state owned and foreign banks account for 34 percent, while domestic private banks account for only 1 percent. For the system as a whole, lending to state owned enterprises (SOEs) made up 35 percent of banking assets at end-2015, while claims on SOEs were 57 percent of all banks' claims on the corporate sector. Individual state-owned banks have accumulated higher exposure to SOEs over time partly due to government programs aimed at developing certain economic sectors, such as woodworking or agricultural machinery, for which lending has been frequently subsidized at rates well below the market.

5. **Overall banking sector capital has been bolstered but remains under pressure through weakened asset quality**. The overall banking sector capital adequacy ratio remained relatively stable at 18.6 percent at the end of 2016, compared to 18.78 percent at the end of 2015. Over the past year, in response to deterioration in the domestic and external macroeconomic environment and a sharp depreciation of the exchange rate, banks have faced a pickup in non-performing loans (NPLs) posing a risk to banks' capital buffers. Banks' NPLs have risen by around 50 percent during the past year to reach 12.6 percent of gross loans at end-2016. At the same time, banking sector profitability, as measured by return on equity, reached 12.6 percent from 10.4 percent at end-2015.

6. **The Belarusian banking sector lacks depth and makes only a relatively small contribution to private sector development.** With a post-crisis private sector loan-to-GDP ratio of 21.2 percent in 2016 (compared to 44 percent in 2010), financial intermediation in Belarus remains significantly below both the Europe and Central Asian average of 96.2 percent and the upper-middle-income country average of 112.1 percent.

7. **Micro, Small and Medium Enterprises (MSMEs) are particularly constrained, especially with regards to loan tenor.** While access to finance is an important factor for enterprise growth, it has become increasingly difficult for private enterprises to obtain funding in the aftermath of the crisis. The banking system channels a disproportionately large part of directed and subsidized credit to SOEs, hampering efficient capital allocation while crowding out private sector banking development at the expense of market-based lending. Overall credit growth to corporates and households has fallen sharply in both national and foreign currency terms since 2013 and turned negative at a constant exchange rate during 2015. In a survey conducted by the World Bank (WB) in 2013, 19 percent of private enterprises identified lack of

access to finance as the single most important obstacle to their growth (up from around 6 percent in 2008), which is relatively high compared to other countries in the region. In addition, only one-third of enterprises surveyed reportedly have a loan, which is significantly lower than the regional average of 42.5 percent. MSMEs in particular find it difficult to obtain affordable financing and are five times more likely than large enterprises to identify access to finance as the biggest obstacle for growth. MSMEs' source of financing for investment and operations is largely limited to their own funds. From 2008 to 2013, the proportion of MSMEs that financed their investments from internal sources rose from 65 percent to 78 percent.

8. **A well-functioning financial sector is, potentially, a critical catalyst for shared, private sector-led growth, but the contribution of Belarus' financial sector remains limited**. Empirical findings confirm a strong causal relationship between a sound financial system and economic growth. A strong financial system promotes more inclusive, shared prosperity by providing enterprises with access to outside capital to fund growth and innovation.

9. **The authorities, with the help of the WB and International Monetary Fund (IMF), are pursuing a comprehensive financial sector reform agenda**. The authorities recognize the difficult dual challenge they face in having to maintain banking sector stability in the face of heightened internal and external pressures, while at the same time looking to transition to a financial system of market-based intermediation with reduced state participation. The financial sector transformation is identified as one of the key components in the Structural Reform Roadmap (2015), prepared by the Government and the National Bank of the Republic of Belarus (NBRB) with WB support. Under the leadership of NBRB, the authorities took a number of steps over the past year to reduce financial sector vulnerabilities and distortions, including bringing DBRB under NBRB's oversight and tightening the criteria for Government Directed Lending (GDL) programs and limiting the resource envelope. Following the 2014 Development Module Financial Sector Assessment Program (FSAP), the authorities asked the WB and the IMF to undertake a full scope FSAP (April 2016) to help elaborate and prioritize the necessary reforms in the areas of financial sector stability and development (see further information on FSAP findings in Annex 4). The authorities are now committed to implementing FSAP recommendations, as evidenced by the preparation of a joint NBRB/Government Action Plan for FSAP implementation, and the five-year *2020 Republic of Belarus Financial Market Development Strategy* adopted in March 2017 aimed at further developing and diversifying the financial sector in Belarus, enhancing competition, correction of basic imbalances, including a reducing dollarization and the use of directed lending and enhancing financial stability.

10. **In support of MSMEs, DBRB aims to scale up its wholesale financing operations to maximize its development impact while sustainably scaling up lending to private enterprises through wholesale channels**. DBRB, created in 2011 to centralize state-directed lending, has become a sizeable institution. The bank, which does not take private deposits and obtains funding mainly from the issuance of government-guaranteed debt, has grown rapidly to become the third-largest financial institution by assets. It acquired assets originated by two state-owned commercial banks under directed lending programs and is now responsible for about one-third of new directed lending. DBRB also acts as an agent for resolving NPLs for the Ministry of Finance (MoF). In 2014, DBRB initiated activities focused on addressing the medium- and long-term funding gaps of MSMEs and enhancing the effectiveness of directed lending. By the end of 2016, the program had disbursed Belarusian Ruble (BYN) 81.9 million through 12 commercial

banks, reaching more than 700 private MSMEs. Going forward, DBRB plans to combine the management of directed lending with more traditional development banking functions, to enhance transparency and efficiency in the allocation of government resources and foster market-based wholesale finance for the private sector. The planned scaling up of wholesale financing will complement and catalyze the activities of commercial banks.

11. **With DBRB playing a growing role in the financial sector, further reforms are required to strengthen DBRB's mandate, governance, and business model arrangements.** DBRB's governance has clearly improved vis-à-vis the rest of the state banks. DBRB's supervisory board now includes 5 independent directors in addition to 3 public officials. The recent transfer of DBRB supervision to the NBRB has significantly strengthened independent oversight. Moreover, four committees reporting to the Supervisory Board have been put in place, including a Risk Committee, Audit Committee, Budget, Remuneration and Appointments Committee, and Strategic Development Committee. Yet much remains to be done to strengthen DBRB's mandate, governance, and business model arrangements. Over the past several months the WB, in close coordination with the IMF, has actively participated in the ongoing discussion about changes to the DBRB legal act (Edict 261) regulating DBRB's activities including narrowing its mandate and strengthening its governance model to ensure the institution focuses on areas of demonstrated market failure and is subject to appropriate external oversight and governance arrangements. Adoption of amendments to the Edict satisfactory to the Bank presents an important precondition for the implementation of institutional reforms under the project. In July 2016, the DBRB Supervisory Board approved its *Strategic Development Plan for 2016-2020* which further outlines reforms aimed at transforming DBRB into a proper development finance institution and the principal agent of directed lending.

C. Higher Level Objectives to which the Project Contributes

12. **The project is consistent with and supports the International Bank for Reconstruction and Development (IBRD)/ International Finance Corporation (IFC) Country Partnership Strategy (CPS) for the FY14-17 period.** The World Bank Group's (WBG) Belarus CPS has three main strategic pillars: (i) improving competitiveness of the economy by supporting structural reforms, including reducing the role of the state, transforming the SOE sector, promoting private and financial sector development and integration into the global economy; (ii) improving quality and efficiency of public infrastructure services, use of agricultural and forestry resources, and global benefits of public goods; and (iii) improving human development outcomes through better education, health and social services. The project supports the first pillar's second results area, namely deepening financial intermediation on market-based terms. The project is also consistent with the government's reform plans[3] as well as the findings of the ongoing Systemic Country Diagnostic which will inform the new Country Partnership Framework for the FY18-22 period.

13. **The project is aligned with the WBG's strategy for achieving the twin goals of**

[3] The Plan of Government's Activities for 2016–2020 approved by Resolution #274 of the Council of Ministers of the Republic of Belarus, dated April 5, 2016.

ending extreme poverty and promoting shared prosperity. The project contributes by supporting a more inclusive and stable financial system. By increasing access and tenors of finance, the project is expected to have a positive impact on the growth of MSMEs and employment, as well as reducing maturity mismatches in the banking sector. One of the positive social impacts of the project may also be on access to finance for female entrepreneurs and on female employment (see Section VI). In addition, the project contributes by supporting the reform of DBRB, through the institutional strengthening component and close monitoring during project supervision of DBRB reforms.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

14. The Project Development Objective (PDO) is to improve access to finance for private MSMEs and enhance the governance and institutional capacity of the DBRB.

B. Project Beneficiaries

15. The project has numerous direct and indirect beneficiaries. DBRB is the primary recipient for financing and TA. Beneficiaries also include Participating Financial Institutions (PFIs) and MSMEs that would obtain financing and TA. The credit line, guaranteed by the Belarusian government, will be intermediated by DBRB through on-lending via PFIs to MSMEs. The institutional strengthening component will benefit DBRB, PFIs, and private MSMEs alike. Belarusian citizens would be the ultimate indirect beneficiaries of a more competitive economy, through job creation, sustainable growth, and more competitive markets for goods and services.

C. PDO Level Results Indicators

16. Key PDO indicators include the following: (i) Growth of DBRB MSME loan portfolio provided through PFIs (percent); (ii) Number of MSME beneficiaries financed by PFIs under the project; and (iii) Strengthened governance and business model of DBRB.

17. Key intermediate indicators and additional indicators, monitored for analytical purposes and aimed to help improve MSME related policies and projects are explored in Section VII. Key intermediate indicators include core indicators, financial performance indicators, compliance with prudential indicators, as well as gender and client engagement indicators (see Section VII). Analytical indicators, such as the performance of MSMEs and their financing, will be monitored for analytical purposes and aim to help improve related policies and projects.

III. PROJECT DESCRIPTION

A. Project Components

18. The project entails three components: (i) a line of credit (LOC) component (USD 56.2 million), (ii) an institutional strengthening component (USD 3.25 million), and (iii) a project management and implementation component (USD 0.55 million). Consistent with good practice in other WB-supported credit lines, DBRB will be the borrower and the implementing agency for this project supported by a Government of the Republic of Belarus (GoB) guarantee.

19. Component 1 will facilitate increased access and availability of finance for MSMEs by financing wholesale lending by DBRB for its MSME business line. DBRB will select PFIs pursuant to criteria agreed with the WB, and subject to no objection by the WB. The selected PFIs will, in turn, provide sub-finance to private MSMEs, the final beneficiaries of the credit line. The PFIs will assume the credit risk of the sub-borrowers that will be selected based on agreed upon eligibility criteria. DBRB will have exposure only to the selected PFIs and will assume the credit risk for on-lending funds to PFIs. An initial appraisal of interested financial intermediaries will be undertaken by the WB, while DBRB will subsequently assume this role with the support of the NBRB, in line with WB requirements for financial intermediary financing. The LoC will be open for participation by all banks meeting eligibility criteria, on a first-come-first-served basis, with an initial set ceiling per institution that may be expanded and/or reallocated as necessary.

20. Sub-finance will be for longer term investment and working capital financing (to accommodate the nature of export finance, potential delays in the payments for goods sold and services provided in an uncertain macro-financial environment, as well as, more generally, to provide flexibility to smaller size enterprises). Revolving funds generated under the project can only be used for repayment of the Bank Loan or to extend new subsidiary financing for PFI sub-loans. Banks wishing to participate in the project's revolving funds shall have to be qualified using the same PFI eligibility criteria and fulfil project implementation requirements as stipulated in the Project Operations Manual (POM). Beyond the support of MSMEs under the project, DBRB is committed to scale up its wholesale financing operations to maximize its development impact while sustainably scaling up lending to private enterprises through wholesale channels.

21. The interest rates charged to final borrowers will be market based. DBRB will on-lend funds to PFIs at interest rates that take into account, at a minimum, DBRB's cost of funding, operating costs, and appropriate credit risk margin. The PFIs will on-lend the funds to final borrowers at market rates based on their own credit risk assessment. Subsidiary finance to PFIs will be denominated in U.S. dollar, with the currency risk being borne by the PFIs and final borrowers.

22. Sub-borrowers will be creditworthy private sector MSMEs. The proposed criteria for final borrowers will follow DBRB's MSME pilot program criteria as well as additional criteria to meet project objectives. The following criteria for MSMEs have been agreed upon during project preparation: (a) privately owned (more than 75 percent) and independent; (b) domestic (more than 50 percent domestically owned); (c) duly licensed and registered with the tax authorities; (d) creditworthy and in sound financial condition; (e) prior operating experience in the activity to be financed; and (f) have organization, management, staff, financial, and other sources required for the efficient carrying out of its operations.

23. The objective of Component 2 is strengthened institutional capacity of DBRB and improved knowledge and awareness of banks and MSMEs. The technical assistance (TA) to be provided under this component builds on an assessment conducted by the WB under the 2014 Development Module FSAP and the 2016 IMF/WB FSAP Update related to institutional, regulatory, and supervisory strengthening of DBRB. The institutional capacity of DBRB will be significantly strengthened through extensive, well-targeted technical assistance and investments. The project will support areas of reform including the following:

- *Governance*: Strengthening of supervisory board practices and procedures including by expanding board member terms in line with the bank strategy, reinforcing the objectivity and independence of supervisory boards, and minimizing the blurring of roles among owners, supervisory board, and management. Operational autonomy for DBRB and prudential supervision exercised independently by NBRB will be ensured through NBRB having exited the supervisory board of DBRB and divesting its equity stake by transferring it to the State Property Committee.
- *Risk management and internal control:* Strengthening of governance arrangements including development of a risk management framework and internal controls system in line with international best practices including the Basel Committee on Banking Supervision and applicable NBRB regulations.
- *Performance assessment:* Strengthening of the monitoring and evaluation (M&E) function including setting up and implementing monitoring, disclosure, and evaluation practices and impact assessment methodologies.
- *Rollout of new finance instruments*: Support the design of programs and instruments to channel directed lending for viable projects based on an assessment of demand and the identification of market gaps, as well as with the aim to better leverage public resources (through public-private partnership (PPP) financing, partial credit guarantees, export guarantees, financial instruments promoting energy efficiency investments for climate change mitigation, etc). Strengthen communication concerning new financing instruments on offer to MSMEs through design of a targeted website. Conduct a study/survey on MSME access to finance constraints assessing demand and supply side factors.
- *Channeling of GDL:* Develop competitive selection processes, monitoring of and reporting for GDL programs, and ex post evaluation of their efficiency and effectiveness to benefit more productive enterprises (private and public) and reduce market distortions.
- *Management Information System (MIS):* Based on DBRB's information technology (IT) strategy, investment in internal systems and information and communication technology (ICT) processes.
- *Capacity building and awareness raising activities*: (1) Seminars, workshops, and conferences aimed at supporting: (i) banks to reach out to MSMEs and improve their governance, risk management, and operational processes; and (ii) capacity-building measures facilitating MSMEs access to finance. (2) Seminars and workshops to strengthen the functioning and capacity of DBRB staff.

24. Component 3 will support the day-to-day PIU functions and related operational costs. It will finance operating costs related to supervision of environmental safeguards, financial management, procurement, project management and monitoring, and translation and interpretation services. It will also invest in software and hardware aimed at the creation of a MSME support program database for project monitoring and reporting.

25. **Annex 1 includes detailed definition of eligibility criteria, and terms and conditions**: (i) the Loan terms and conditions between IBRD and DBRB; (ii) the eligibility criteria for the PFIs that will be financed by DBRB, and the terms and conditions of subsidiary finance between DBRB and PFIs; and (iii) the eligibility criteria for the MSMEs that will be financed by PFIs, and the terms and conditions of sub-finance between PFIs and MSMEs.

B. Project Cost and Financing

26. **The proposed investment project financing uses IBRD funds, with DBRB as the Borrower.** The loan repayments will be guaranteed by the Republic of Belarus. The total amount of the loan will be US$60 million. Details of the project cost and financing and allocation among components are provided in the table below.

Table 1. Estimated Project Cost and Financing

Project Components	IBRD Financing (US$, millions)
Component 1: Line of Credit to MSMEs	56.20
Component 2: Institutional Strengthening of DBRB	3.25
Component 3: Project Management and Implementation	0.55
Total	**60.00**

C. Lessons Learned and Reflected in Project Design

27. **The project will leverage the WB's comparative advantage in offering competitively priced long-term funds, by building on international experience in designing line of credit interventions and facilitating institutional reform of development finance institutions (DFIs).** The Project incorporates lessons from recent, ongoing and completed World Bank Group and donor projects, international best practices in MSME finance, and the World Bank OP 10.00 Guidelines on Financial Intermediary Financing. It also incorporates good practices identified in the 2006 Independent Evaluation Group's (IEG) evaluation of World Bank Lending for Lines of Credit. Overall, lessons learned point to: (i) a simple and flexible design, allowing for operational adjustments, and avoiding sectoral or regional targets; (ii) intensive monitoring of key indicators that measure the quality of the loan portfolio; (iii) use of quantified eligibility criteria for selecting PFIs; and (iv) availability and use of sound analysis and data on the financial performance of PFIs, and external audit for verification.

28. **Transparent reporting, sound governance arrangements, and independent and effective regulation and supervision, as well as wholesale business models, are key lessons learned in developing sustainable DFIs.** Accurate and detailed financial and performance reporting is essential in maintaining a self-sustaining institution. Independent regulation and supervision by the financial sector regulator, rather than a line ministry with conflicts of interest,

further enforces the disciplined prudent management of a DFI. Experience in South Africa and Brazil suggests the importance of tightly defined mandates, clear performance targets, transparent reporting, and insulation from political interference. DFIs that apply strong corporate governance standards generally perform better. International experience relating to DFI reform, e.g. in Mexico, confirms that wholesale DFIs (second tier institutions) that provide incentives to private sector banks to enter new markets perform better than DFIs that engage in retail operations.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

29. **The project will be implemented by a Project Implementation Unit (PIU) housed at DBRB. The PIU will be established and staffed with qualified personnel capable of satisfactorily implementing all aspects of the project.** Its responsibilities will include: (i) selection of and on-lending to PFIs; (ii) monitoring of PFIs to ensure compliance with project criteria; (iii) responsibility for adherence to all fiduciary and safeguard requirements of the WB for final borrowers; and (iv) M&E based on key indicators.

30. **A detailed financial intermediary assessment of DBRB was conducted during project preparation, including World Bank Operational Policy (OP) 10.0 eligibility.** The appraisal pointed to the fact that DBRB has adequate and sound policies, administrative structures, and business practices to ensure its capacity to operate efficiently, sustainably, and transparently. The overall assessment observed that DBRB has demonstrated that it can efficiently fulfill its mandate. Annex 5 provides an overview of the appraisal summary as well as suggested areas for actions. Governance and credit risk management weaknesses are expected to be addressed under the institutional strengthening component of the loan. A presidential decree mandating external supervision of DBRB by the NBRB was adopted in May 2016. Close monitoring during supervision will ensure that reforms within DBRB's powers are undertaken in a timely and satisfactory manner.

31. **PFIs will be selected by DBRB (subject to WB no objection) based on their financial health, as well as their capacity to implement sub-projects.** An initial appraisal of interested financial intermediaries will be undertaken by the WB (six of which have already been conducted), while DBRB will subsequently assume this role with the support of the NBRB, in line with WB requirements for financial intermediary financing. DBRB takes the credit risk of PFIs and therefore has a strong incentive to carefully assess their financial health and operational capabilities. The PFI selection is also subject to a no-objection process by the WB, while Subsidiary Finance Agreement covenants between DBRB and PFIs require compliance with local regulations thereby supporting the continued financial health of the PFIs. If PFIs do not effectively implement the project, they may be substituted for other eligible PFIs. The PFIs responsibilities will include promotion and building of the project pipeline; appraisal of the sub-project to be financed and of the creditworthiness and financial condition of the potential borrowers; assisting borrowers in the application of efficient procurement practices; performing an environmental review of sub-financing requests which incorporates the procedures described in the Environmental Management Framework (EMF); making sub-financing related payments

in a timely manner against appropriate documents (to evidence use of funds, procurement aspects) and ensuring that payments of interest and principal to DBRB are made as due; preparing annual external audits and keeping all necessary records and payment evidence, as specified in legal documents; and providing periodic reports to the PIU.

B. Results Monitoring and Evaluation

32. **The Borrower will evaluate progress on the proposed indicators through regular reports.** DBRB's PIU will monitor the PDO and intermediate indicators of the Results Framework (which includes MSME finance core indicators for Bank-wide monitoring and gender and client engagement indicators, Section VII) on a regular basis. The results monitoring and evaluation for the project will build upon DBRB's existing systems. Targeted ad hoc evaluations could be designed and undertaken to assess innovative initiatives under Component 2. Finally, data on PFIs - in line with NBRB regulatory requirements - will be used to monitor their performance over time. The PIU will prepare semiannual project reports. The financial performance of DBRB will be monitored through independent auditors' reports and separate management letters confirming adherence to prudential norms. A mid-term survey on Citizen Engagement will seek feedback from the MSME beneficiaries on their satisfaction with the sub-financing. The PIU will discuss the survey results with PFIs and the results will inform project implementation, as appropriate. Further details on the Results and Monitoring Framework are provided in Section VII. The Core Intermediate Results Indicators offer no baseline or targets, as PFIs have not been preselected and the indicator collection is for analytical purposes and project implementation adjustments.

C. Sustainability

33. **Sustainability of the project is based on DBRB acting as a catalyst by encouraging greater intermediation by the financial sector while refraining from creating distortions in financial markets**. Moreover, the WB's financing support to MSMEs will go hand in hand with further institutional strengthening of DBRB. The instrument deployed by DBRB—on-lending to financial intermediaries—will be designed with market-conforming terms. Rather than replacing markets, the DBRB will enhance them by providing term financing to financial intermediaries to on-lend to MSMEs at maturities that are otherwise unavailable to this sector. A rigorous accreditation procedure for borrowing from DBRB—as well as TA for DBRB and PFIs—will help improve their governance, risk management, and operational processes. The WB will be tracking progress throughout the project's implementation. While the WB can play an important catalytic role at this stage by providing the sector with long-term financing that is currently scarce, it is expected that, in the long run, the country will return to macro-financial stability and alternative sources will be developed. Moreover, activities under the project form an integral part of the overall initiative, supported by the IMF and the WB, to strengthen and further develop the financial sector and are closely aligned with the government's structural reform agenda and its financial sector development strategy as well as DBRB's 2016-2020 strategy.

34. **To avoid market distortions, DBRB and the PFIs will follow their respective pricing policy according to market conditions.** The cost of on-lending subsidiary financing through PFIs will include, at a minimum, the cost of IBRD funds to DBRB plus an on-lending margin

reflecting DBRB's administrative costs, a credit risk margin associated with the PFI, and fees to the MoF for the Guarantee provision. Ultimate beneficiary cost will add, at a minimum, the PFI's administrative costs, and a credit risk margin associated with the MSME. The only significant market advantage from using the WB financing is in terms of maturity, facilitating the provision of longer term finance to enterprises without taking on a significant maturity mismatch.

D. Role of Partners

35. The implementation of broader range of financial and private sector reforms is also supported by the IMF, the EU, the European Bank for Reconstruction and Development (EBRD), the Organization for Economic Co-operation and Development (OECD) and the United Nations. A summary of some of the main development partners' activities are listed in Annex 1.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

36. The overall risk to the operation is substantial as a number of areas are judged to have 'substantial' risks, including macroeconomic, institutional capacity for implementation and sustainability, and fiduciary risks.

37. Macroeconomic. The country has been going through an economic recession, but its pace is currently slowing, with prospects for recovery in 2018–2019. Although macroeconomic stabilization has been supported by tight monetary and fiscal policies, the financial sector remains challenged in key areas of its efficiency, including consequences of distortive credit allocation. There is a risk of a disorderly unwinding of financial sector imbalances as large historic lending at subsidized rates, especially in foreign currency to insufficiently-hedged borrowers, has contributed to rising shares of bad loans in the banking system and exposed banks to currency-induced credit risks. The persistence of unresolved credit hampers the functioning of the banking system and limits its ability to finance new and healthy businesses, especially in the private sector. The proposed project, through its support of private enterprises, will not only help private enterprises to access finance but also introduce key institutional reforms of DBRB, in order to ensure that the distortive impacts of directed lending is minimized

38. Institutional capacity for implementation and sustainability and fiduciary risks. The project could also potentially be delayed or negatively affected by DBRB's lack of experience in implementing WB projects, in particular with safeguards and procurement procedures. The establishment of a dedicated implementation unit at DBRB and the development of a Project Operations Manual (POM) outlining detailed procedures on project implementation, as well as the respective controls, are expected to mitigate these risks. In addition, DBRB is undergoing important reforms as part of the authorities' strategic plans to implement key FSAP recommendations. A slowdown in the reform process could have a negative impact on sub-project preparation and implementation and will be monitored closely by the WB. Close monitoring during supervision will ensure that reforms within DBRB's powers are undertaken in a timely and satisfactory manner. To mitigate this risk, the Bank will include in its supervision team a cadre of experts on PFI due diligence, financial management, environmental safeguards, and procurement, who will give hands-on guidance to DBRB and its PIU.

Table 2: SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Low
9. Other	
OVERALL	**Substantial**

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

39. **MSMEs, the ultimate beneficiaries, are expected to gain greater access and longer loan terms.** Sub-projects to be funded are not pre-identified and project costs are not defined, thus a traditional economic/financial analysis cannot be conducted. Nevertheless, the Development Module FSAP (Access to Finance, 2014) has revealed that, while access to finance is an important factor for enterprise growth, it has become increasingly difficult for private enterprises to obtain funding in the aftermath of the crisis. The banking system channels a disproportionately large part of directed and subsidized credit to SOEs, hampering efficient capital allocation while crowding out private sector banking development at the expense of market-based lending. The project is expected to increase availability and tenors from participating financial intermediaries to private MSMEs. The specific eligibility criteria, terms and conditions (including minimum sub-financing maturities) are defined in Annex 1. In addition, by supporting finance for MSMEs, the project could have a positive impact on employment.

40. **The rationale for public intervention in the provision of long term finance to the private financial sector is driven by the lack of alternatives in the short term.** Catalyzing economic sector growth requires developing the private sector and providing more capital intensive and sophisticated products. This places the emphasis on the provision of longer term finance, which is constrained due to the macro-financial environment, the shallow capital

markets, and underdeveloped financial infrastructure. In addition, during economic downturns, working capital becomes a priority for enterprises as they typically experience delays in the payments for goods sold and services provided.

41. **In addition, the project will help DBRB in its mandate re-orientation and reform process.** The WB has been providing advisory support to the authorities, helping shape DBRB's reform activities. The proposed Loan will assist DBRB in re-orienting its institutional, governance, and business model arrangements. These reforms for DBRB are critical, and the WB will be following the reform process closely during project implementation to ensure that reforms within DBRB's powers are undertaken in a timely and satisfactory manner.

B. Technical

42. **Several background papers serve as the analytical underpinning of the project.** Those include the Development Module FSAP (Access to Finance, 2014); IMF/WB FSAP Update 2016; Roadmap for Structural Reforms in the Republic of Belarus (2015); a joint NBRB/Government Action Plan for FSAP; and the five-year Financial Sector Development Strategy (2017).

43. **The financial condition of DBRB is analyzed in Annexes 4 and 5, and the financial terms and conditions are laid out in Annex 1.** Provisions are included in the project to ensure that interest rates reflect the cost of intermediating project funds and appropriate risk margins.

44. **Six out of the universe of potential eligible PFIs were analyzed at the time of project preparation and found satisfactory, with decisions on inclusion expected by effectiveness and during supervision.** A preliminary assessment was performed by the WB, supported by DBRB, during project preparation, identifying six commercial banks that would meet PFI eligibility criteria. Discussions during project preparation point to demand for the project's funds from a number of other commercial banks, and these discussions are expected to continue with the signing of at least two Subsidiary Financing Agreement, satisfactory to the WB, forming a condition of effectiveness.

C. Financial Management

45. **The project financial management systems at DBRB are Satisfactory. A FM assessment concluded that the DBRB is capable of administering activities under the project**. The DBRB has adequate and sound policies, administrative structures, and business practices to ensure its capacity to operate efficiently, sustainably, and transparently. The overall assessment observes that the DBRB has demonstrated that it can efficiently fulfill its mandate. Identified areas of improvement are observed as not significantly affecting its ability to undertake project activities and most are being addressed by this operation. These areas include the following:

- Preparation of an operational manual to guide the management of the LoC and cover internal control and oversight arrangements. Relevant due diligence procedures should be reflected in the POM to be applied in approving and monitoring the use of project funds by beneficiaries, and the scope of audits should include test checking in compliance with the project's expenditure requirements.

- Managing the LoC, including adequate staffing, expanding the existing IT system, and preparation and adoption of operational procedures.

46. **Integrated accountability and progress reports will be prepared by DBRB on a semiannual basis and will be submitted to the WB for review**. These reports will include information on the accountability of project funds alongside progress toward the achievement of project objectives and shall be relied on for WB reporting purposes. To the extent possible, the WB will rely on existing semiannual financial statements, usually reviewed, certified, and published by DBRB. The timeline for submission of interim financial reports to the WB will be within 45 days after the end of each reporting period.

47. **DBRB will be required to have its annual financial statements prepared in accordance with International Financial Reporting Standards and audited in accordance with International Standards on Auditing.** Audited financial statements will be submitted to the WB within six months following the end of each financial year. As required by the WB's access to information policy, audited financial statements will be publicly disclosed by both DBRB and the WB. DBRB's existing annual financial reporting and auditing arrangements are considered acceptable to the WB.

D. Procurement

48. **Procurement activities and fiduciary obligations under the project will be carried out by DBRB's PIU.** Procurement of goods, works, and non-consulting services for the project will be carried out in accordance with the WB's 'Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and International Development Association (IDA) Credits and Grants', dated January 2011 and revised in July 2014 (Procurement Guidelines); and procurement of consultant services will be carried out in accordance with the WB's 'Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by WB Borrowers', dated January 2011 and revised in July 2014 (Consultant Guidelines) and the provisions stipulated in the Project Loan Agreements. The WB's 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants', dated October 15, 2006 and revised in January 2011 (Anticorruption Guidelines), will apply to the project.

49. **Procurement and consultant selection under the LoC will be carried out in accordance with well-established private sector procurement methods or commercial practices acceptable to the WB.** These are detailed in 'Procurement in Loans to Financial Intermediary Institutions and Entities', paragraph 3.13 of the Procurement and Consultant Guidelines of January 2011.

50. **An assessment of DBRB has been carried out and concluded that DBRB may need to strengthen its capacity to carry out and oversee the procurement activities under the project due to lack of prior experience in implementation of WB financed projects and no experience with the Bank's procurement procedures.** The Procurement Plan covering the technical assistance component of the project has been agreed with DBRB. The procurement risk associated with DBRB is Substantial. A brief summary of the procurement arrangements,

including risk mitigation measures which have been discussed and agreed by DBRB, is provided in Annex 2.

E. Social (including Safeguards)

51. The project is not expected to have negative social effects. By increasing access and tenors of finance, the project is expected to have a positive impact on the growth of MSMEs and employment. One of the positive social impacts of the project may also be on access to finance for female entrepreneurs and on female employment. The project will collect indicators on gender for analytical purposes and towards the design of future projects. More specifically, an indicator will cover the percentage of MSME beneficiaries financed under the project with at least 15 percent female participation in their workforce. The project beneficiaries are MSMEs, and the project will ensure that DBRB collects and responds to feedback from these beneficiaries as necessary to inform implementation of this project, and possibly the design of future projects. Under a mid-term survey (year 2) on Citizen Engagement, the final beneficiaries will be surveyed on their satisfaction with the sub-finance received to determine if it met their needs (including a gender related disaggregation). However, the survey will not include satisfaction with the PFIs' decisions related to the sub-financing size, terms, and conditions, as these need to be market based (as required by OP10). Survey results will be discussed with PFIs and MSMEs, reported in mid-term, and will inform project implementation, as appropriate.

52. Gender. Project activities will benefit both male and female entrepreneurs through improved access to finance and capacity-building activities. The 2013 Belarus Gender Profile has shown that women frequently face the 'double burden' of having to combine professional and family duties. This challenge makes it difficult for many women to maintain their jobs as employees in the 'formal' work sector and strengthens the appeal of small businesses, which allow more flexibility. As an increasing number of households are headed by women or consist only of women, small businesses improve the material well-being of these households and mitigate the risk of poverty. However, women frequently lack the skills needed to open or maintain a business. In addition, female entrepreneurs could significantly benefit from training to be included in project activities. Some training activities will be tailored to the particular needs of women. The POM will include a clause to ensure that women and men have equal opportunities to access financing.

53. The project will also improve understandings of the needs and challenges of female entrepreneurs by collecting previously unavailable data. There is a shortage of reliable data on female employment and, specifically, on female entrepreneurs. Disaggregation of data collected by the project by gender will contribute to understanding the issues faced by female entrepreneurs.

54. Involuntary resettlement. The project will not trigger OP/BP 4.12 on Involuntary Resettlement. Involuntary resettlement resulting in relocation or loss of shelter, loss of assets or access to assets, or loss of income sources or means of livelihoods (whether or not there is physical relocation), or involuntary restriction of access to legally designated parks and protected areas will not be eligible for financing. One of the eligibility criteria for PFIs and MSMEs would be that any sub-project applications presenting situations that would otherwise require triggering of OP/BP 4.12 will not be eligible for financing under the project. This criteria will also be reflected in the POM. However, rehabilitation or reconstruction (which could involve demolition of a no longer suitable structure and construction of a new one) of existing buildings within the same footprint would be permissible as long as this does not include involuntary loss of assets, or cause any other impacts that would otherwise require triggering of OP/BP 4.12.

F. Environment (including Safeguards)

55. **In accordance with the WB Policy on Environmental Assessment (OP/BP 4.01), the project has been broadly assigned Environmental Category B, and an Environmental Management Framework (EMF) follows WB policies on consultations and disclosure.** Some subprojects with minor or no negative environmental impacts will be classified as Category C. In most cases, mitigation measures proposed in project documents can prevent and significantly minimize negative impacts. If mitigation measures are properly implemented, the project will mainly have a positive impact on the environment and human health as a result of infrastructure development of MSME businesses.

56. **The EMF (in Russian) was disclosed in-country on DBRB and Ministry of Economy (MoE) websites on July 7, 2016.** The English version of the EMF was disclosed in the WB's InfoShop. The public consultation with different stakeholders regarding the disclosed EMF took place on July 14, 2016. The EMF was developed to describe the procedures and mechanisms that need to be used to ensure that the project activities comply with Belarusian legislation and the requirements of IBRD.

57. **The EMF will be incorporated in the POM of the LoC.** In essence, the EMF addresses procedures and responsibilities of the PIU and PFIs for key elements of the environmental review process, namely (a) compliance with the GoB environmental assessment requirements, (b) screening, (c) documentation, (d) public consultation, (e) disclosure, (f) review and approval, (g) conditionality, and (h) monitoring and reporting. Only Category B and C subprojects will be eligible for financing under the project. The subprojects that require a full-scale environmental impact assessment under Belarusian legislation will not be financed.

58. **Subprojects which may trigger the safeguards policies of the WB such as Natural Habitats - OP/BP 4.04, Forests - OP/BP 4.36, Pest Management - OP 4.09, Physical Cultural Resources - OP/BP 4.11, Involuntary Resettlement - OP/BP 4.12, Indigenous Peoples - OP/BP 4.10, Safety of Dams - OP/BP 4.37, and Projects on International Waterways - OP/BP 7.50 will not be financed by the WB.** If a subproject falls under Category B, further preparation of an Environmental Management Plan (EMP) is required. The EMF provides the recommended EMP structure and EMP checklist for small-scale works under Category B subprojects, which can help in developing necessary mitigation measures. If the subproject is related to Category C as a result of screening, no further actions are required. The EMPs for subprojects shall be developed by qualified specialist(s) as contracted by the beneficiary and approved by PIU which has an environmental and social specialist. The EMPs should be in agreement with the WB and should be corrected as necessary. The EMP developed for individual subprojects requires mandatory public consultations.

G. Citizen Engagement

59. The Project will include a citizen engagement action in the form of a mid-term survey. A mid-term survey on Citizen Engagement (year 2) will seek feedback from the MSME beneficiaries on their satisfaction with the sub-financing. The PIU will discuss the survey results with PFIs and the results will inform project implementation, as appropriate. Further details on Citizen Engagement-related activities are provided in the Results and Monitoring Framework (including indicators) in Chapter VII. Under a mid-term survey on Citizen Engagement, the final beneficiaries will be particularly surveyed on their satisfaction with the sub-finance received to determine if it met their needs (including a gender related disaggregation, longer term working capital and investment finance, etc).

H. Other Safeguards Policies Triggered

60. No other safeguards policies will be triggered. The expected social and environmental impacts considered during the project preparation process are reflected in sections E and F, respectively.

I. World Bank Grievance Redress

61. Communities and individuals who believe that they are adversely affected by a WB supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the WB's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the WB's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the WB Inspection Panel, please visit www.inspectionpanel.org.

VII. RESULTS FRAMEWORK AND MONITORING

Country: Belarus

Project Name: Belarus MSME Access to Finance Project (P152276)

Results Framework

Project Development Objectives

PDO Statement

The Project Development Objective (PDO) is to improve access to finance for private MSMEs and enhance the governance and institutional capacity of the Development Bank of the Republic of Belarus.

These results are at	Project Level

Project Development Objective Indicators

Indicator Name	Baseline	Cumulative Target Values				
		YR1	YR2	YR3	YR4	End Target
Growth of DBRB MSME loan portfolio provided through participating financial institutions (PFIs) (percent) (Percentage)	0.00	25.00	80.00	130.00	170.00	170.00

Number of MSME beneficiaries that obtained credit under the project (Number)	0.00	30.00	80.00	120.00	150.00	150.00
Governance and business model of DBRB strengthened (Text)	No	No	No	No	Yes	Yes

Intermediate Results Indicators

Indicator Name	Baseline	Cumulative Target Values				
		YR1	YR2	YR3	YR4	End Target
Volume of loans disbursed under the project (US$, millions) (Amount(USD))	0.00	10.00	25.00	41.20	56.20	56.20
Number of active PFIs under the project (cumulative) (Number)	0.00					5.00
Portfolio Quality: Portfolio at risk (%) (Text)	13.3					n/a

Financial Sustainability: Return on Assets (%) (Text)	3.2					n/a
Financial Sustainability: Return on Equity (%) (Text)	14.4					n/a
Compliance with prudential regulation (Text)	Yes					Yes
Gender: share of businesses beneficiaries that obtained credit under the project with at least 15 percent female workforce participation (percent) (Text)	0					n/a
Citizen Engagement: MSMEs that report that project sub-finance reflected their needs (Percentage) (Text)	0					>90

Indicator Description

Project Development Objective Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Growth of outstanding DBRB MSME financing provided through participating financial institutions (PFIs) (percent)	US$33 million outstanding portfolio to commercial banks in support of private MSMEs as of January 1, 2017 corresponds to the baseline of 0%. The growth rate will include all of DBRB's financing activities to commercial banks in support of private MSMEs both via the Bank-financed portion and DBRB's own MSME programs.	Annual	DBRB/PIU	DBRB
Number of MSME beneficiaries that obtained credit under the project	Number of MSME beneficiaries that obtained credit under the project during the reporting period	Semiannual	PFI and PIU reports	DBRB, PFIs
Governance and business model of DBRB strengthened	DBRB’s strengthened governance and business model ensures that the bank (i) operates on a financially sustainable basis, (ii) is in compliance with applicable NBRB regulations, (iii) operates increasingly on a wholesale basis (with new loans and guarantees extended via other Belarusian banks), (iv) has a majority of independent supervisory board members, and (v) NBRB exited the supervisory board and divested from its equity stakes.	Semiannual	PIU reports	DBRB

Intermediate Results Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection

Volume of loans disbursed under the project (US$, millions)	Volume of MSME loans, disbursed under the on-lending agreements between PFIs and MSMEs in the reporting period	Semiannual	PFI and PIU reports	DBRB, PFIs
Number of active PFIs under the project (cumulative)	PFIs that have signed an SFA and extended sub-finance.	Semiannual	PFI and PIU reports	DBRB, PFIs
Portfolio Quality: Portfolio at risk (%)	The indicator is not MSME specific and follows the local definition for NPLs, as regulated by NBRB. The top indicator will report on DBRB. However, the accompanying text will report by PFI, both the entire portfolio and the Bank-financed portion.	Semiannual	PFI and PIU reports	DBRB, PFIs
Financial Sustainability: Return on Assets (%)	The top indicator will report on DBRB. However, the accompanying text will report by PFI.	Semiannual	PFI and PIU reports	DBRB, PFIs
Financial Sustainability: Return on Equity (%)	The top indicator will report on DBRB. However, the accompanying text will report by PFI.	Semiannual	PFI and PIU reports	DBRB, PFIs
Compliance with prudential regulation	The top indicator will report on DBRB. However, the accompanying text will report by PFI.	Annual	PFI and PIU reports	DBRB, PFIs, NBRB
Gender: share of businesses beneficiaries that obtained credit under the project with at least 15 percent female workforce participation (percent)	Share of businesses beneficiaries that obtained credit under the project with at least 15 percent female workforce participation. Data to be collected as part of credit application. Cumulatively, from the beginning of the project.	Semiannual	PFI and PIU reports	DBRB, PFIs
Citizen Engagement: MSMEs that report that project sub-finance reflected their needs (Percentage)	A mid-term beneficiary feedback survey will measure the satisfaction of the sub-beneficiary (MSMEs) with the sub-finance in term of their needs (e.g. longer term working capital and investment finance).	Mid-term	Survey-basis	PIU

	This will exclude satisfaction with PFI decisions related to the size, terms and conditions that need to be market based (as required by OP10). The survey results will be discussed with PFIs with a view to inform the project implementation, as appropriate.			

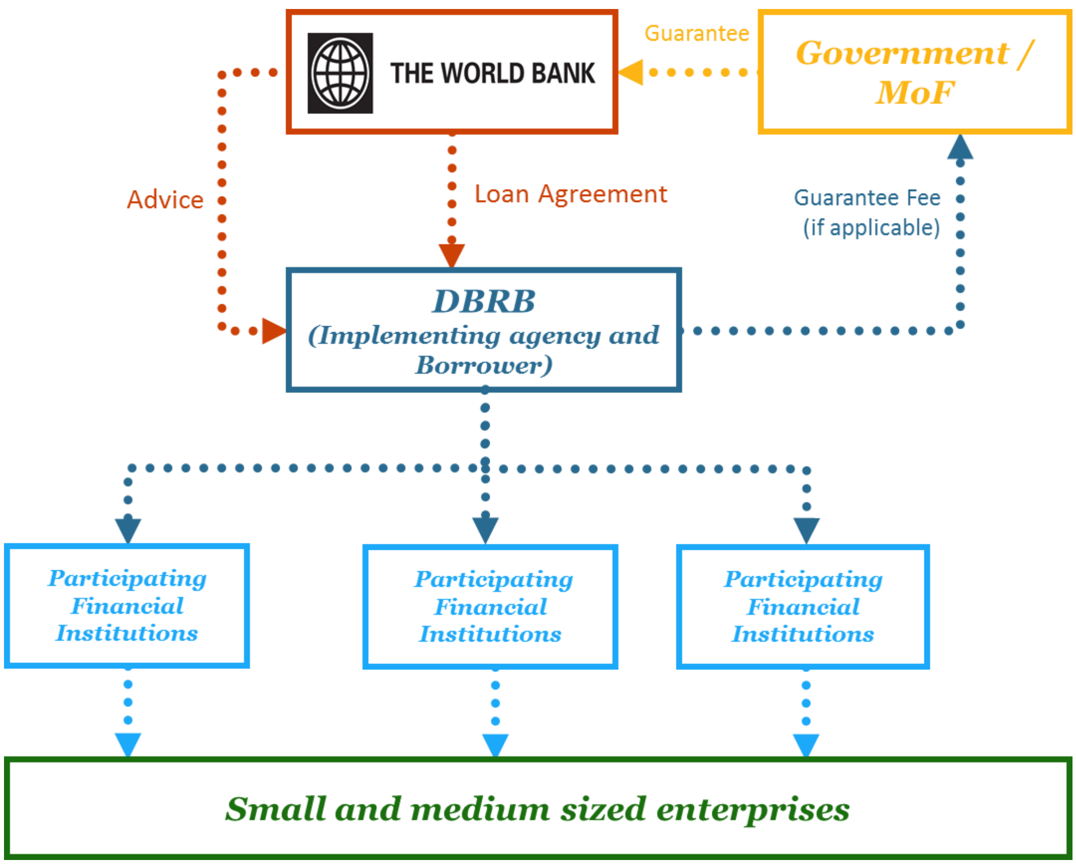
Annex 1: Detailed Project Description

BELARUS: MSME Access to Finance Project (P152276)

Component 1: Line of Credit to MSMEs

1. **Consistent with good practice in other WB credit lines, DBRB will be the borrower and implementing agency for this component through the DBRB Loan Agreement, supported by a GoB guarantee**. Such arrangements help safeguard the independence of the DBRB and participating commercial banks from potential interference by any state body in LoC decisions, which is a potential risk in the context of Belarus. Also, by its nature, an LoC will result in a large number of individual payments to banks that will need to be processed very fast. Experience in other transition economies has demonstrated that a qualified financial institution is far more agile in this respect than government bureaucracy. Moreover, a direct Loan Agreement will allow the WB financing support to MSMEs to go hand in hand with further institutional strengthening of DBRB. Finally, it is important that DBRB be the WB's counterpart in the Loan Agreement to build DBRB's credentials as a reliable borrower and partner in the international arena. These implementation arrangements would be fully consistent with the lessons drawn from the WB's extensive engagement in LoC operations in other Europe and Central Asian countries (for example, Turkey, Ukraine, and Croatia).

Figure 1.1. Structure for the LoC Flow of Funds



2. The following terms and conditions are described in summary:

(a) Loan terms and conditions between the WB and DBRB;

(b) Subsidiary financing terms and conditions for DBRB's on-lending to PFIs;

(i) Eligibility criteria for the PFIs that will be financed by DBRB;
(ii) Terms and conditions of subsidiary financing between DBRB and PFIs;

(c) Sub-finance terms and conditions for PFIs' sub-project financing to MSMEs;

(i) Eligibility criteria for the MSMEs that will be financed by PFIs;
(ii) Terms and conditions of sub-finance between PFIs and MSMEs;

(a) Loan terms and conditions between the WB and DBRB

- DBRB selection of IBRD Loan characteristics will take place prior to Negotiations.
- DBRB will extend an estimated US$56.2 million of Loan proceeds to PFIs, using Subsidiary Financing Agreements (SFAs). Selection of PFIs and all SFAs are subject to prior review and acceptance by the WB.
- DBRB will maintain, during project implementation, a PIU with procedures, responsibilities, and staffed with qualified personnel capable of implementing all aspects of the project in a satisfactory manner.
- DBRB must be in compliance with the requirements listed in the Project Operations Manual (POM).
- For the duration of the project implementation period, beginning with the year 2017, DBRB will submit annually an audit report that is prepared by an international auditor and is in accordance with International Auditing Standards and International Financial Reporting Standards.
- DBRB will be subject to monitoring of the PDO and Intermediate Results indicators in the "Results Framework and Monitoring" and the Additional indicators in the POM on a regular basis (see Section VII).

(b) Subsidiary financing terms and conditions for DBRB's on-lending to PFIs

3. Initial appraisal of interested financial intermediaries will be undertaken by the WB, while DBRB will be subsequently tasked with this role, with support from the NBRB, in line with WB requirements for financial intermediary financing. DBRB will on-lend PFIs an expected US$56.2 million of Loan proceeds. Before final selection of the PFIs, DBRB will submit to the WB the evaluation report, including financials of the proposed PFIs, together with a request to include the PFIs in the project. The WB will review and clear DBRB's assessment by conveying no objection for each PFI's participation. The no objection will be based on the criteria included in this section, and the WB's own PFI due diligence as necessary. DBRB will send the financials of the proposed PFIs to the WB every year to ensure that the selected PFIs continue to meet the required criteria throughout the life of the project.

(i) Eligibility criteria for the PFIs that will be financed by DBRB, unless agreed otherwise by the WB:

4. PFIs will be selected based on their expression of interest in participating in the project

and on acceptance by DBRB of their credit risk, as well as the following eligibility criteria:

- the bank must be duly licensed and at least two years in operation;
- the bank's owners and managers must be considered 'fit and proper'—it must have good governance, qualified and experienced management, and adequate organization and institutional capacity for its specific risk profile;
- it must be in 'good standing' with the NBRB (that is, it observes prudential regulations and all applicable laws);
- it must have well-defined policies and written procedures for management of all types of financial risks (liquidity, credit, currency, interest rate, and market risk, as well as risks associated with balance sheet and income statement structures);
- it must maintain capital adequacy, with the minimum risk-based capital adequacy ratio as per the NBRB regulation;
- it must have adequate liquidity and meet the minimum liquidity prescribed by prudential regulations (the NBRB's regulation requires a minimum of 20 percent);
- it must have positive profitability and an acceptable risk profile—it must maintain the value of its capital;
- it must have adequate portfolio quality, proper classification of its assets, and off-balance-sheet credit risk exposures and must make adequate provisions;
- it must have adequate internal audits/controls for its specific risk profile; and
- it must have adequate management information systems.

(ii) Terms and conditions of subsidiary financing between DBRB and PFIs, unless agreed otherwise by the WB:

- PFIs must start and remain in compliance with the eligibility criteria for PFIs. The right of a PFI to use the proceeds of its respective SFA shall be suspended or terminated if the PFI is not in compliance with the eligibility criteria or other obligations under the project, unless the WB provides its No Objection (for example, based on the presentation of the PFI's agreement with NBRB on a time-bound action plan).
- The funds available to PFIs will depend upon the availability of funds to DBRB from the WB.
- The cost of subsidiary funds will include, at a minimum, the cost of the WB funds to DBRB plus an on-lending margin reflecting: (a) DBRB's administrative costs, and (b) a credit risk margin.
- PFIs will be responsible for ensuring that sub-beneficiaries comply with the applicable Belarusian environmental legislation and regulations, and the WB policy on environmental assessment.
- PFIs will provide DBRB with a set of documentation for all sub-finance to enable it to maintain all project records and make them available for ex-post review by the WB or by external auditors as necessary.
- PFIs and MSMEs will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for a certain period after the project), as may be requested by the WB and DBRB.

(c) Sub-finance terms and conditions for PFIs' sub-project financing to MSMEs.

(i) Eligibility criteria for the MSMEs that will be financed by PFIs, unless agreed otherwise by the WB:

- For the purpose of this project, MSMEs are defined as firms having up to 250 employees and a volume of proceeds (net of value added tax) smaller than BYN 25 million;
- privately owned (more than 75 percent) and independent;
- domestic (more than 50 percent domestically owned);
- duly licensed and registered with the tax authorities;
- creditworthy and in sound financial condition;
- prior operating experience in the activity to be financed; and
- have organization, management, staff, financial, and other sources required for the efficient carrying out of its operations.

(ii) Terms and conditions of sub-finance between PFIs and MSMEs, unless agreed otherwise by the WB:

- Sub-finance will be evaluated in accordance with PFI's normal project and finance evaluation guidelines. DBRB will ascertain the eligibility of the sub-finance provided by PFIs to ensure that they meet the project requirements, but will not conduct its own evaluation of sub-finance.
- The cost of sub-finance by PFIs to MSMEs will include, at a minimum, the cost of the project funds to PFIs plus an on-lending margin reflecting: (a) PFI's administrative costs, and (b) a credit risk margin.
- Sub-finance to MSMEs may be made for working capital and investment purposes.
- The aggregate amount of outstanding Sub-finance to any one MSME shall not exceed US$2.5 million equivalent.
- The maximum individual loan size amounts to US$500 thousand working capital, US$1 million for investment loans
- All working capital sub-finance must have at least six months and up to 4 years of maturity, with a grace period up to 6 months. All investment sub-finance to MSMEs must have at least 24 months maturity and a maximum maturity of 10 years, with up to 2 years of grace period.
- Sub-beneficiaries must submit a cash flow statement (or other form of financial reporting) following a format agreed upon with DBRB.
- Sub-beneficiaries should, after the receipt of the sub-finance, be projected to maintain a financial debt service coverage ratio of at least 1.2:1 and calculated on an average basis over the sub-finance life, unless agreed otherwise by the WB.
- The first two sub-finances by each PFI, irrespective of size, will be subject to prior review by the WB. Sub-finances to be provided to a MSME exceeding US$1 million equivalent will require prior approval by the WB.
- All sub-finance not subject to prior review may be subject to ex-post review by DBRB or by the WB to verify compliance with the terms and conditions.
- MSMEs (sub-beneficiaries) and sub-projects must meet environmental and social laws and standards in force in Belarus. The WB policy on environmental and social assessment will also be complied with.
- Sub-projects involving natural habitats, indigenous peoples, forests, dams, disputed areas, involuntary resettlement, and international waterways will not be financed.

- MSMEs will be required to keep copies of invoices for all expenses financed with working capital and investment finance received under the project. MSMEs will be required to send to their respective PFIs invoices and other documentation for sub-finance, except in the case of non-procurement working capital expenditures. MSMEs will send the evidence of non-procurement expenses financed with working capital finance to the PFIs. The invoices/documentation for these expenses will be kept by the MSMEs and made available to the PFIs, DBRB, and the WB on request.
- Sub-beneficiaries will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for certain period after the project), as may be requested by the WB, and/or DBRB.
- Sub-projects on the WB's negative list will not be eligible for financing.
- Sub-beneficiaries are required to comply with the WB's "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants," dated October 15, 2006, and revised January 2011 (Anti-Corruption Guidelines) as part of its general obligations relating to the receipt and use of such proceeds of the Loan.

Component 2: Institutional Strengthening of DBRB

5. **Following the global financial crisis, many countries have expanded the role of state-owned DFIs to restore lending to the real sector.** According to a recent European Commission Communication,[4] so-called national promotional banks have an important role in catalyzing long-term investment and counterbalancing the deleveraging process in the commercial banking sector. When well managed, they can promote development by supporting underserved sectors of the economy, such as MSMEs, poor regions, or lagging sectors, and provide catalytic funding for long-term investment. However, many DFIs have failed in the past, and it is therefore important to avoid distortions in their institutional and governance set-up. The effectiveness of their support depends largely on the quality of their institutional and governance framework, and their ability to mobilize private funding by providing appropriate products.

6. **In line with FSAP findings**, **DBRB's mandate should be clarified and its operations limited to clear market failures not adequately addressed by the banking sector (such as major infrastructure projects, export financing, MSMEs, rural finance, credit enhancements)**. To make sure that DBRB does not crowd out the banking sector, DBRB should act solely as a wholesale bank in all state programs with a retail component (similarly to its current MSME finance program) and should not take deposits from the public. It should offer direct financing only to viable investment projects that have been rejected by at least two commercial banks, or where DBRB direct financing, syndicated lending, and co-financing with other private investors or lenders is necessitated by the large scale and exposure limits of other banks. Limits can be set on the minimum loan amount and maturity for loans extended by DBRB directly to clients, including infrastructure. It may also be advisable to establish a cap on DBRB's share in direct project financing to avoid allocating DBRB's resources to a few large projects and in order to mobilize additional private sector resources under DBRB's wholesale lending and PPPs. The current DBRB MSME finance program deserves further enhancement

[4] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0361&from=en

and expansion. DBRB's lending to banks in the form of deposits should be replaced by subsidiary loan agreements secured by the rights on accounts receivables. With DBRB's increased role in development finance NPL transfers to the bank should cease.

7. **DBRB's governance has clearly improved vis-à-vis the rest of the state banks, yet much remains to be done**. The DBRB board now includes 5 independent directors in addition to 3 public officials. However, supervisory board practices and procedures present similar shortcomings evidenced in other state banks, and their fiduciary responsibilities are limited. Issues include low meeting frequency, presence of senior management in each supervisory board meeting, poor transaction reporting back to the board, and independent member's high frequency rotation with short term appointments (1 year, renewable). The independent directors are handpicked by senior management and appointments are ratified at the general assembly of shareholders. Furthermore, NBRB's minority stake (0.14 %) in the bank's equity compromises NBRB's independence and conflicts with its financial regulation and stability mandate. Therefore, NBRB should, after exiting the supervisory board of DBRB in 2017, divest its equity stake by transferring it to the State Property Agency.

8. **Component 2 supports strengthening of the institutional, corporate governance, and supervisory arrangements of DBRB**. This component will provide operational support and capacity building to DBRB as well as knowledge and awareness-raising activities targeting banks and MSMEs. The TA provided under this component will build on WB assessments (2014 Development Module FSAP and 2016 FSAP Update) related to institutional, regulatory, and supervisory strengthening of DBRB. Areas of TA include (a) strengthening of the functioning of DBRB, including establishing robust operating principles, policies, procedures, and governance, design and roll-out of new finance instruments, setting up and implementing monitoring, disclosure, and evaluation practices, and impact assessment methodologies; (b) implementation of DBRB's IT strategy to enhance internal systems and ICT processes; and (c) knowledge and awareness-raising activities targeting banks and MSMEs.

Component 3: Project Management and Implementation

9. **Component 3 will support the day-to-day PIU functions and related operational costs.** It will finance operating costs related to supervision of environmental safeguards, financial management, procurement, project management and monitoring, and translation and interpretation services, as well as investments in software and hardware aimed at the creation of a MSME support program database for project monitoring and reporting.

Annex 2: Implementation Arrangements

BELARUS: MSME Access to Finance Project (P152276)

Project Institutional and Implementation Arrangements

1. **DBRB will be responsible for project implementation.** The PIU responsibilities will include: (i) selection of and on-lending to PFIs; (ii) monitoring of PFIs to ensure compliance with project criteria; (iii) responsibility for adherence to all fiduciary and safeguard requirements of the WB for final borrowers; and (iv) monitoring and evaluation based on key indicators. DBRB's PIU is staffed with capable and qualified personnel for the implementation of the project.

Financial Management, Disbursements, and Procurement

Financial Management

Project-specific Financial Management Issues

2. **A financial management assessment was initiated in September 2015 and completed in July 2016.** The objective of the financial management assessment was to determine whether the project's implementing entity has acceptable financial management arrangements to support implementation of the project activities. These arrangements include budgeting system, funds flow, accounting and internal controls, auditing, and reporting. The project's arrangements are acceptable if they are considered capable of recording correctly all transactions and balances, supporting the preparation of regular and reliable financial statements, and safeguarding the project's assets, and are subject to auditing arrangements acceptable to the WB. WB policy requires that acceptable accounting and internal control systems are in place when project implementation begins; Europe and Central Asia (ECA) projects must have such arrangements in place by the time the project is presented to the Board.

Assessment of Country-level Public Financial Management (PFM) and Banking Sector Issues

3. **A 2014 Public Expenditure and Financial Accountability report on Belarus observes a strong state presence in the economy, with implications for PFM, including application of uniform procedures and processes across all levels of public budget, strong role of the MoF in determining PFM procedures, and a highly centralized treasury system.** Identified issues include (a) a lack of performance focus in budgeting; (b) a strong focus on compliance in financial control and inspection activities, rather than efficiency and performance; (c) absence of an internal audit function; and (d) use of fragmented IT systems. The report gives relatively high scores for budget credibility but average scores for comprehensiveness and transparency. It observes that while basic recording of transactions is effective, annual reports on budget execution are not comprehensive, and national accounting standards are not consistent with International Public Sector Accounting Standards. Independent audit coverage is reasonably comprehensive, yet, neither the audit reports nor the methodology are disclosed. The project responds to these pertinent issues by including in its design (a) reliance on the existing institutional arrangements of DBRB and (b) reliance on existing arrangements for disclosure of DBRB's audited financial statements.

4. **As the LoC component will be implemented by a financial intermediary, an analysis of Belarus' banking sector was undertaken and results were reflected in the technical assessment.** The assessment observes that adequate macroeconomic policy and sector development frameworks are in place and that risks and other deficiencies in the sector (several of which will be addressed by the project) appear to be manageable or, if needed, susceptible to rectification. The assessment concludes that the PDO can be realized with due regard for efficiency and sustainability in Belarus' prevailing macroeconomic policies and environment and by the policies affecting the structure and prospects of the financial sector.

5. **A financial management assessment was carried out, focused on DBRB as implementation agency.** The assessment concluded that proposed financial management arrangements for the implementation of the project were acceptable to the WB, subject to satisfactory implementation of enhancements outlined in the following paragraphs.

6. **DBRB has adequate and sound policies, administrative structures, and business practices to ensure its capacity to operate efficiently, sustainably, and transparently.** The assessment observes that DBRB has demonstrated that it can efficiently fulfill its mandate. Identified areas for improvement, including the following, are not expected to significantly affect its ability to undertake project activities, and most are being addressed by this operation.

- Preparation of an operational manual to guide the management of the LoC and cover internal control and oversight arrangements. Relevant due diligence procedures should be reflected in the POM to be applied in approving and monitoring the use of project funds to beneficiaries, and the scope of audits should include test checking of compliance with expenditure requirements.

- The establishment of sufficient capacity to manage the LoC, including adequate staff, expanding of the existing IT system, and preparation and adoption of operational procedures.

Funds Flow and Disbursement Arrangements

7. **The WB funds will be disbursed under standard transactional procedures**, including direct payments from the relevant project loan accounts and disbursements through designated accounts.

8. **Disbursement of the funds will be undertaken through opening and maintaining of a designated account in U.S. dollars at DBRB which is considered acceptable to the WB**. The ceiling for this account will be indicated in the disbursement letter. Applications for replenishment of the account will be submitted quarterly or when one-third of the amount has been withdrawn, whichever occurs earlier. Documentation requirements for replenishment will follow standard WB procedures as described in the Disbursement Handbook. Monthly bank statements of the account, which have been reconciled, will accompany all replenishment requests.

9. **A Disbursement Letter will outline specific modalities** for processing withdrawal applications, disbursements, and management of the designated account, to be considered during project negotiations.

10. **The WB shall not be required to make a deposit into the designated account in the**

following circumstances: if (a) the WB, at any time, is not satisfied with the evidence and supporting documentation required as specified above; or (b) the borrower shall have failed to furnish to the WB, within the time specified, any of the audit reports required to be furnished to the WB.

11. **The WB may request additional eligibility evidence of expenditure or a refund.** If the WB determines at any time that payment out of the designated account or DBRB foreign currency account was made for an expenditure that is not an eligible expenditure or was not justified by the evidence furnished to the WB, the borrower shall, promptly upon notice from the WB, provide such additional evidence as the WB may request or deposit into the designated account (or, if the WB shall so request, refund to the WB) an amount equal to the amount of such payment. Unless the WB shall otherwise agree, no deposit by the WB into the designated account shall be made until the borrower has provided such evidence or made such deposit or refund, as the case may be. Refunds made to the WB shall be credited to the loan account for subsequent withdrawal or for cancellation in accordance with the provisions of the Loan Agreement.

Financial Reporting

12. **Integrated accountability and progress reports will be prepared by DBRB on a semiannual basis and will be submitted to the WB for review**. These reports will include information on the accountability of project funds alongside progress toward the achievement of project objectives and shall be relied on for WB reporting purposes. To the extent possible, the WB will rely on existing semiannual financial statements, usually reviewed, certified, and published by DBRB. The time line for submission of interim financial reports to the WB will be within 45 days after the end of each reporting period.

External Audit

13. **DBRB will be required to have its annual financial statements prepared in accordance with International Financial Reporting Standards and audited in accordance with International Standards on Auditing.** Audited financial statements will be submitted to the WB within six months following the end of each financial year. As required by the WB's access to information policy, audited financial statements will be publicly disclosed by both DBRB and the WB. DBRB's existing annual financial reporting and auditing arrangements are considered acceptable to the WB.

Financial Management Action Plan

14. The following remedial actions were agreed as a result of the assessment:

Table 2.1. Remedial Action Plan

Number	Action	Due Date
1	POM is drafted and submitted to the WB for review and comments (DBRB).	September 2017
3	Minimum systems and capacity elements acceptable to the WB are in place.	By project effectiveness date

15. Preliminary estimates for the project's disbursements are presented in Table 2.2.

Table 2.2. Preliminary Project Disbursement Schedule

Project/Year	1	2	3	4	5	Total
LoC/Institutional Strengthening of DBRB/Project Management and Implementation	10.00	15.00	20.00	10.00	5.00	60.00
Total	**10.00**	**15.00**	**20.00**	**10.00**	**5.00**	**60.00**

Procurement

16. **General.** Procurement of goods, works, and non-consulting services for the project will be carried out in accordance with the WB's 'Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by WB Borrowers', dated January 2011 and revised July 2014 (Procurement Guidelines), and procurement of consultant services will be carried out in accordance with the WB's 'Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by WB Borrowers', dated January 2011 and revised July 2014 (Consultant Guidelines) and the provisions stipulated in the Loan Agreement. The WB's 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants', dated October 15, 2006, and revised in January 2011 (Anti-Corruption Guidelines) will apply to the project. A General Procurement Notice will be published on the WB's external website and the United Nations Development Business website. The following section describes the procurement implementation arrangements agreed with the borrower.

Procurement Capacity and Risk Assessment

17. **A Procurement Capacity and Risk Assessment of DBRB was undertaken in September 2015.** DBRB PIU will be directly responsible for the implementation of all procurement activities related to institutional capacity building and implementation of the new IT strategy. DBRB PIU has not yet been set up. It will need to hire a procurement specialist, who is fully qualified and knowledgeable regarding the WB's procurement rules and procedures. The project procurement activities are limited to a few consultancy contracts of relatively small value and three ICT related contracts to enhance ICT processes in DBRB. The WB will provide additional procurement training for the PIU staff to ensure smooth project implementation. One DBRB representative has recently been trained in the use of the Bank's Systemic Tracking of Exchanges in Procurement System (STEP), that will be used under this project.

18. **Given the findings of the assessment as presented in the previous paragraph, the procurement risk for the project is rated Substantial.** The key issues and risks concerning procurement for the implementation of the project include (a) unfamiliarity of DBRB with the WB's procurement policies and procedures; (b) potential risk of delays in the implementation of the procurements, especially first tendering procedures and more complex ICT related procurement packages; and (c) poor quality of contract deliverables.

19. **To mitigate the identified procurement-related risks, the following mitigation actions were agreed between the WB and DBRB during project preparation:**

Table 2.3. Mitigation Action Plan

No.	Mitigation Measure	Responsible Party	Deadline
1	Organize procurement training for the staff involved in project procurement activities (DBRB) in the WB's Procurement and Consultant Guidelines and Standard Bidding Documents (SBDs).	WB	Negotiations
2	Prepare a detailed Procurement Plan for the first 18 months of the implementation of the project.	DBRB PIU	Appraisal
3	Organize business outreach for potential bidders or consultants before launching the first bidding procedures.	DBRB PIU	Negotiations
4	Start preparation of the bidding documents for the first year of project implementation well in advance to facilitate the initiation of the procurement procedures as soon as the project becomes effective.	DBRB PIU	Negotiations
5	DBRB PIU will hire a procurement specialist who is familiar with the WB's procurement.	DBRB PIU	Within 30 days from effectiveness
6	The WB's procurement specialist will work closely with the PIU and will organize procurement refresher training events for project staff whenever required during project implementation.	WB	Recurrent
7	The borrower will prepare procurement progress reports during project implementation.	DBRB PIU	Implementation

Procurement Implementation Arrangements

20. **Procurement of works.** Currently, the project's components do not envisage civil works contracts. If, during project implementation, there is a need for smaller works (under National Competitive Bidding procedure), the WB's SBDs for procurement of small works will be used for contracts below US$5 million per contract. For very small value civil works contracts estimated to cost not more than US$200,000 per contract, a shopping procedure may be used. Under the LOC, private sector commercial practices for civil works may be used.

Procurement of Goods and Non-Consulting Services

21. **Procurement of goods.** The most recent version of the WB's SBDs for goods shall be used for all International Competitive Bidding (ICB) above US$1 million per contract. For contracts below US$1 million, the WB's sample bidding documents for goods under National Competitive Bidding may be used and a shopping procedure for goods estimated to cost up to the equivalent of US$100,000 per contract. Logistical services for training and workshops related to capacity building shall be procured as non-consulting services. With respect to ICT-related procurement envisaged under the project, the following different procurement strategies may be applied: (a) goods approach—a general-purpose hardware and off-the-shelf software (without customization) based on SBD for goods, (b) consulting services approach—if the hardware and packaged software content is minimal, for example, less than 20 percent of the estimated contract value, a consultancy selection procedure may be applicable with the WB's Standard Request for Proposal, (c) single stage IT SBD—if procurement package combines critical goods and services elements, sophisticated hardware requiring an informed performance comparison and special training requirements, a dominating value of the software packages, extra installation and support requirements for the software packages, software design, large-scale adaptation and/or development, and requirements for the supplier to continue to operate the equipment after installation, for contracts requiring pricing for both investment and recurrent costs (life cycle).

22. **Commercial practices.** The LoC main component of the project will be carried out in accordance with well-established private sector procurement practices as per paragraph 3.13 of the Procurement Guidelines and for consulting services contracts, in accordance with paragraph 3.13 of the Consultant Guidelines. The POM will describe the basic guiding principles and acceptable procedures under this component. These principles shall include, among others, mandatory provisions that beneficiaries of the loan shall not award contracts to their parent of affiliate companies unless there is an established arm's-length arrangement. Private sector commercial practices may be followed for goods, works, and non-consulting services contracts and for consulting services contracts. Because of the demand-driven nature of this component, it is not possible to estimate either the sub-borrowers or their procurement requirements at the appraisal stage of the project. Therefore, it is not possible for the financial institutions to develop a Procurement Plan that provides the basis for the procurement methods. All commercial practices contracts will be post reviewed by the WB as specified in the agreed POM.

23. **Logistical and organizational services for international and national symposia, seminars, workshops, and other training programs (if needed) will be procured using shopping procedures.** In the case of very large training programs, exceeding the threshold of US$100,000, the procurement will be advertised at least 30 days in advance in the national or international press as appropriate, and bidding documents agreed by the WB will be used. Training activities in the form of study tours, or participation in national or international workshops, and training programs shall be procured in accordance with the procedures agreed with the WB.

24. **Selection of consultants.** The project will support several consultancy contracts under the project such as: assessment of the risk management system of DBRB, assessment of the internal audit and control system of DBRB, review of the compliance and anti-money laundering (AML) systems, design of the budgeting and financial reporting system. For assignments estimated to cost US$300,000 or less per contract, the short list may entirely comprise national consultants.

25. **Hiring of government-owned universities and research centers.** The project may involve participation of a number of state research institutes and universities. The WB will review on a case-by-case basis (at the time of launch of the specific assignment) whether these entities would meet the WB's eligibility requirements (paragraph 1.13 of the WB's Consultant Guidelines), including the WB's policy on conflict of interest (paragraph 1.9 of the WB's Consultant Guidelines).

Procurement Plan and Procurement Thresholds

26. **DBRB has developed a Procurement Plan for the first 18 months of the project.** This plan has been agreed between the PIU and the WB and will be published on the WB's external website after the project loan negotiations. The Procurement Plan will be updated at least annually or as required to reflect actual project implementation needs. Procurement under the project will include the following categories: goods and non-consulting and consulting services. The applicable thresholds for procurement methods and WB prior review applied for procurement are presented in Table 2.4.

27. **The WB will review the procurement arrangements as performed by DBRB PIU.** Currently, all procurement packages are subject to the Bank's post-review. The procurements not receiving prior review by the WB will be subject, on a random basis, to the WB's ex post review

in accordance with the procedures set forth in Appendix 1 of the Procurement and Consultant Guidelines. The Bank will review approximately 15% of all contracts signed that were subject to the Bank's post-review. The ex post review of procurement documents will normally be undertaken during the WB's implementation support missions or as the WB may request for any contract at any time.

Project Procurement Plan

28. **The major procurement packages are indicated in the simplified plan in table 2.4.** The detailed Procurement Plan is available as a separate document.

Table 2.4. Simplified Procurement Plan

Contract Package	Contract Description	Type	Procurement Method	Review Method	Expected Bid/ Proposal Opening Date	Expected Contract Completion Date
	Consultant services for diagnostics, technical design and implementation support of the IT strategy	CS	QCBS	Post	August 2018	January 2019
	Strengthening communication concerning new financing instruments on offer to MSMEs through design of respective websites	CS	CQS	Post	November 2018	June 2022
	Study/survey on MSME access to finance constraints assessing demand- and supply-side factors	CS	CQS	Post	October 2018	June 2022
	Project management and monitoring: IT infrastructure/software for creation of an MSME support program database for project monitoring and reporting	G	ICB	Post	January 2019	June 2022
	Procurement of software and hardware to enhance internal systems and ICTB processes of DBRB	G	ICB	Post	January 2019	June 2022

Note: CQS = Selection Based on Consultants' Qualification; CS = Consulting Services; G = Goods; IC = Individual Consultant; QCBS = Quality- and Cost-Based Selection.

Environmental and Social (Including Safeguards)

29. **The EMF provides guidance to borrowers for meeting the requirements of the national legislation in accordance with WB safeguard policies.** These include a description of the basic procedures of the WB relevant to the project; identification of the potential positive, negative, and cumulative impacts on the environment and measures to minimize and prevent these impacts; guidelines for preparation of subproject EMPs; and requirements to the procedure of monitoring the implementation of the EMP for individual subprojects.

30. **The EMPs for each subproject will be prepared by the sub-borrowers.** Control over the EMP's implementation is assigned to DBRB PIU. The PIU has developed a number of eligibility criteria for the different entities for loans targeting different sectors of the economy. The responsibilities of the PIU/PFIs include, among others, further monitoring of the

effectiveness of LoC utilization.

31. **Involuntary resettlement.** The project will not trigger OP/BP 4.12 on Involuntary Resettlement. Involuntary resettlement resulting in relocation or loss of shelter, loss of assets or access to assets, or loss of income sources or means of livelihoods (whether or not there is physical relocation) or involuntary restriction of access to legally designated parks and protected areas will not be eligible for financing. One of the eligibility criteria for PFIs and MSMEs would be that any sub-project applications presenting situations that would otherwise require triggering of OP/BP 4.12 will not be eligible for financing under the project. This criteria will also be reflected in the POM. However, rehabilitation or reconstruction (which could involve demolition of a no longer suitable structure and construction of a new one) of existing buildings within the same footprint would be permissible as long as this does not include involuntary loss of assets, or cause any other impacts that would otherwise require triggering of OP/BP 4.12.

32. **The project will not support any subprojects or grants that would necessitate involuntary land acquisition or any form of resettlement.** The POM to be prepared by the borrower will specify that private businesses will be eligible to become project beneficiaries under the condition that they have not acquired and/or would not acquire land for the needs of activities to be supported with the project proceeds through a process that involved and/or would involve land expropriation. Additionally, project funds will not support any subloans used to invest in a business that would require the involuntary displacement of existing occupants or economic users of any plot of land, regardless of its current ownership, or loss of or damage to assets including standing crops, kiosks, fences, and other. The LoC Operations Manual will define a screening procedure to be followed, and the implementing agency (DBRB) will closely monitor the screening procedure with the support of the WB.

33. **In cases where new construction is involved, sites presenting situations (acquisition through a process which involved land expropriation and involuntary displacement of existing occupants) that would trigger OP 4.12 will be excluded from project consideration**. However, rehabilitation or reconstruction (which could involve demolition of a no longer suitable structures and construction of new ones) of the existing buildings within the same footprint would be permissible.

Monitoring and Evaluation

34. In addition to the indicators under Section VII, the project will monitor some additional indicators. These indicators will be monitored for analytical purposes only and will serve as useful inputs to define policies and projects aimed at further improving MSMEs' access to finance in Belarus:

(i) *Performance of MSMEs under the project:* (i) Increase in exports.

(ii) *Profile of MSMEs under the project:* (i) Size of MSMEs (number of employees); (ii) Economic sector; (iii) Geographical location.

(iii) *Profile of finance under the project:* (i) Size of sub-finance; (ii) Maturity of sub-finance.

35. The following Table describes the arrangements for monitoring for the Additional Indicators.

Table 2.5: Additional Indicators and Arrangements for Monitoring

Indicator Name	Frequency	Data Source/ Methodology	Responsibility for Data Collection
Performance of MSMEs under the project			
Increase in exports	Annual	Project report	PIU
Profile of MSMEs under the project			
Size of MSMEs (number of employees)	Annual	Project report	PIU
Economic sector	Annual	Project report	PIU
Geographical location	Annual	Project report	PIU
Profile of loans under the project			
Size of sub-finance	Annual	Project report	PIU
Maturity of sub-finance	Annual	Project report	PIU

Role of Partners

IFC

36. The Investment Climate Advisory Project in Belarus is being implemented by the Trade and Competitiveness Global Practice on behalf of IFC working to improve the legal and regulatory environment in Belarus and enhance the implementation of new regulations to encourage SME sector growth. The project also aims to increase export potential and private sector competitiveness by reducing the administrative burden, simplifying procedures, and helping implement international standards.

IMF

37. **In response to a GoB request, the IMF is considering the inception of a new program for Belarus to support the country's macroeconomic adjustment and structural reforms.** It is expected that a potential new IMF program might include, among others, policy reforms in such areas as SOE governance, government support programs to the real sector, and sustainability of the financial sector, and as such, it would complement the activities supported under the project.

European Bank for Reconstruction and Development (EBRD)

38. **The EBRD's priorities are toward promoting private sector development across all sectors of the economy, both directly and indirectly.** They include supporting the transparent privatization of state-owned entities and assets; assisting partner banks to deepen financial intermediation in underserved segments and geographic areas and improve access to finance by

MSMEs; and continuing to engage the GoB through policy dialogue to implement structural reforms that support private sector development and improve the country's investment climate. To support commercialization of the financial sector, the EBRD will offer operations to private and foreign-owned banks and consider supporting nonbank financial institutions to further broaden access to finance by private sector players. The EBRD also provides assistance to SMEs through a direct advisory program[5] (Advice for Small Businesses) related to business support. The goal of the program is to help small and medium-size businesses grow, succeed, and then grow again, becoming genuine catalysts for Belarusian economy. The project connects SMEs to local consultants and international advisers who can help transform a huge range of businesses.

Organization for Economic Co-operation and Development (OECD)

39. **The OECD is currently advising the GoB on the design of a reform road map to improve SME capabilities through a sustainable business support infrastructure.** The project is co-funded by the European Union (EU) within the framework of the Eastern Partnership SME Panel and carried out as a follow-up to the SME Policy Index: Eastern Partner Countries 2016 - Assessing the Implementation of the Small Business Act for Europe (EBRD, European Training Foundation, EU, and OECD - 2015) report. The Government (Ministry of Economy) with the project support prepared a practical policy reform roadmap for SME support, with a focus on upgrading SME capabilities through business support services. The Road Map was presented at the OECD Eurasia Competitiveness Roundtable (Paris, November 2016). Now the Government (MoE as the main coordinator) is implementing the Road Map with OECD expert team involvement.

United Nations Development Programme (UNDP)

40. **The UNDP, jointly with United States Agency for International Development (USAID), launched a multiyear project[6] to support the growth and development of private MSMEs through local economic development strategies in ecotourism, funding of competitively selected local initiatives, and private sector training and informational support.** This Low Emissions Asian Development project aims to strengthen the private sector's contribution to local economies by providing TA and small grants for local initiatives in the eco-tourism industry to MSMEs, local and regional administrations, and the general public and business community at large.

EU

41. **EU–Belarus cooperation is based on successive Conclusions of the Foreign Affairs Council of the EU**. Projects supported by the EU in Belarus follow the guidelines of the Country Strategy Paper and National Indicative Program. The main areas of EU work are social inclusion, environment, and local and regional economic development. Belarus is also involved in regional

[5] http://www.ebrd.com/work-with-us/advice-for-small-businesses/belarus.html%20
[6] http://un.by/ru/undp/db/

and cross-border cooperation projects in areas such as transport, border management and customs, migration and asylum, measures against human and drug trafficking, management of man-made and natural disasters, and other areas of regional and cross-border importance. The regional dimension is also addressed through the multilateral domain of the Eastern Partnership. The overall objective of the project is to promote sustainable regional development in Belarus through developing competencies and capacities of Belarusian regional and local authorities in regional and local development management.

USAID

42. **One of the main areas of USAID work in Belarus is Private Sector Development and Entrepreneurship**. USAID supports Business Edge™ training that strengthens the management skills of SMEs. USAID is supporting private sector development in Belarus by providing business training and informational support to current and future private sector actors and promoting regulatory reforms aimed at improving the business environment, increasing opportunities for business, and developing business support organizations, partnerships, and professional networks. USAID, in partnership with IFC, is working to simplify regulatory requirements and make doing business easier. The IFC Investment Climate Advisory Project is focusing on supporting the growth of small and medium businesses by enhancing policies and regulations and increasing the international competitiveness of local producers by reducing compliance costs and improving trade logistics.

Annex 3: Implementation Support Plan

BELARUS: MSME Access to Finance Project (P152276)

Strategy and Approach for Implementation Support

1. **The implementation support strategy was developed taking into account the risks and mitigation measures related to the operation and targets the provision of flexible and efficient implementation support to the clients.**

(a) **Technical Support** – IBRD implementation support missions will include a Financial Sector Specialist to help guide DBRB with project implementation and policy dialogue.

(b) **Procurement** – A procurement specialist will carry out supervision and will participate in project implementation support missions and site visits, respond to just-in-time requests and provide ongoing guidance to DBRB based on its procurement activities.

(c) **Financial Management** – During project implementation, the WB will supervise the project's financial management arrangements in two main ways: (i) review the project's semiannual integrated accountability and progress reports as well as DBRB's annual audited financial statements; and (ii) during the WB's implementation support missions, review the project's financial management and disbursement arrangements to ensure compliance with the WB's minimum requirements. As required, a WB-accredited Financial Management Specialist will assist in the supervision process.

(d) **Safeguards** – A Project Implementation Unit (PIU) will be established at DBRB. As DBRB has not implemented any WB Loans before, implementation support will need to be provided, especially by the WB Specialists on Environmental Safeguards and Procurement.

Implementation Support Plan and Resource Requirements

Time	Focus	Skills Needed	Resource Estimate
Year 1	Task management	Project management (HQ based)	8 staff weeks (SWs)
	Technical reviews	Financial Sector Specialist (Kiev based)	6 SWs
	Procurement support	Procurement Specialist (Warsaw based)	4 SWs
	FM supervision	FM Specialist (Kiev based)	3 SWs
	Safeguards	Environmental specialist (Sarajevo based)	4 SWs
Year 2-4	Task management	Project management (HQ based)	6 SWs per year
	Technical reviews	Financial Sector Specialist (Kiev based)	4 SWs per year
	Procurement support	Procurement Specialist (Warsaw based)	4 SWs per year
	FM supervision	FM Specialist (Kiev based)	3 SWs per year
	Safeguards	Environmental specialist (Sarajevo based)	4 SWs per year

Annex 4: Financial Sector and DBRB Background

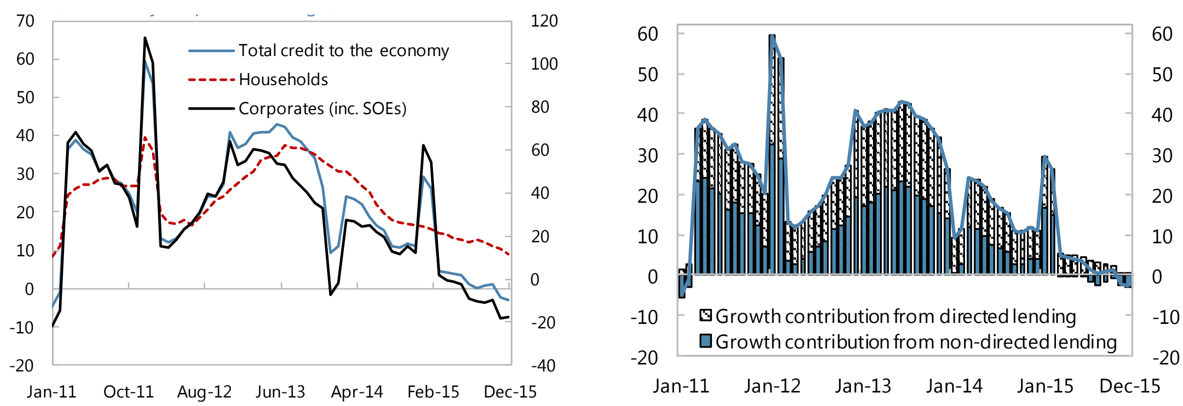
BELARUS: MSME Access to Finance Project (P152276)

Financial Sector Background[7]

1. **The financial system has a high degree of government involvement and is bank dominated.** The majority of the financial sector comprises commercial banks, which constitute about 84 percent of assets, equivalent to 73 percent of GDP. The remainder of the assets is shared among DBRB (7 percent), the insurance sector (3 percent), and leasing and microcredit companies (slightly more than 5 percent). Within the banking sector, the largest 10 banks make up most of the banking system. Of these, the top five as well as two foreign banks are part of conglomerates. Nearly 65 percent of total assets are state owned and foreign banks account for 34 percent, while domestic private banks account for only 1 percent. State-owned banks do not operate on a level playing field with private banks, because they are able to offer government-subsidized interest rates to customers.

2. **The Belarusian banking sector lacks depth.** With a post-crisis private sector loan-to-GDP ratio of 21.2 percent in 2016 (compared to 44 percent in 2010), financial intermediation in Belarus remains significantly below both the European and Central Asian average of 56 percent and the upper-middle-income country average of 98 percent. Overall credit growth to corporates and households has fallen sharply in both national and foreign currency terms since 2013 and turned negative at a constant exchange rate during 2015. During this period, the growth of state-directed lending nearly halved, mainly due to high debt amortization (see Figure 4.1).

Figure 4.1. Credit to the Economy at Constant Exchange Rate (Year-over-Year % Change)



Source: NBRB and staff calculations.

3. **Overall banking sector capital has been bolstered but remains under pressure through weakened asset quality and profitability.** The overall banking sector capital adequacy ratio remained relatively stable at 18.6 percent at the end of 2016, compared to 18.78 percent at the end of 2015. Over the past year, in response to deterioration in the domestic and external macroeconomic environment and a sharp depreciation of the exchange rate, banks have faced a pickup in NPLs posing a risk to banks' capital buffers. Banks' NPLs have risen by around 50

[7] See 2016 FSAP Update for further information.

percent during the past year to reach 12.6 percent of gross loans at end-2016. At the same time, banking sector profitability, as measured by return on equity, reached 12.6 percent from 10.4 percent at end-2015.

4. **The banking sector of Belarus is characterized by high levels of dollarization with associated credit and liquidity risks.** The share of foreign exchange loans has grown up to 70 percent of total loans to the private sector at the beginning of 2017 compared to one-third of the portfolio at the beginning of 2010, while foreign currency–denominated liabilities reached 74 percent of total liabilities. New credit to the private sector has been increasingly provided in foreign exchange given the high and volatile interest rates in Belarusian rubles, which have made local currency credit unsuitable to finance economic activities. This has prompted a shift toward foreign exchange borrowing by enterprises, which carries not only much lower interest rates (currently, around 6.9 percent compared to around 15 percent in Belarusian rubles for newly extended credit over one-year maturity as of Q1 2017) but also high foreign exchange risk. Banks indicate that they have required additional cash buffers from unhedged borrowers in foreign currency, sometimes as much as 50 percent more to mitigate the risk.

5. **Banks carry high credit risk exposure to weak-performing SOEs.** For the system as a whole, lending to SOEs made up 35 percent of banking assets at end-2015, while claims on SOEs were 57 percent of all banks' claims on the corporate sector. Individual state-owned banks have accumulated higher exposure to SOEs over time partly due to government programs aimed at developing certain economic sectors, such as woodworking or agricultural machinery, for which lending has been frequently subsidized at rates well below the market.

6. **While access to finance is an important factor for enterprise growth, it has become increasingly difficult for private enterprises to obtain funding in the aftermath of the crisis as bank lending has shifted toward large state-owned firms.** Large SOEs appear to have ample access to financing at concessional terms. The banking system channels a disproportionately large part of directed and subsidized credit to SOEs hampering efficient capital allocation while crowding out private sector banking development at the expense of market-based lending. Continued lending to the saturated SOE sector at subsidized rates promotes further inefficiency and the misallocation of resources in the economy. In a survey conducted by the WB in 2013, 19 percent of private enterprises identified lack of access to finance as the single most important obstacle to their growth (up from around 6 percent in 2008), which is relatively high compared to other countries in the region (see Figure 4.2) In addition, only one-third of enterprises surveyed reportedly have a loan, which is significantly lower than the regional average of 42.5 percent (see Table 4.1).

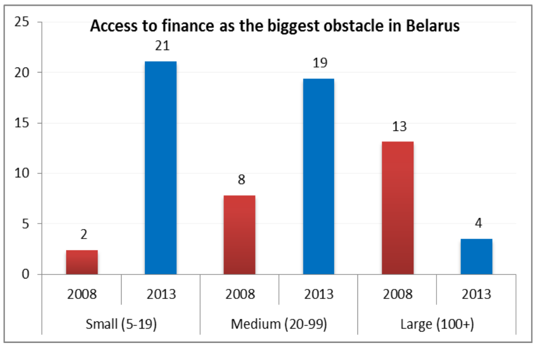
Table 4.1. Percentage of European and Central Asian Firms with Financial Accounts and Loans/Credit Lines

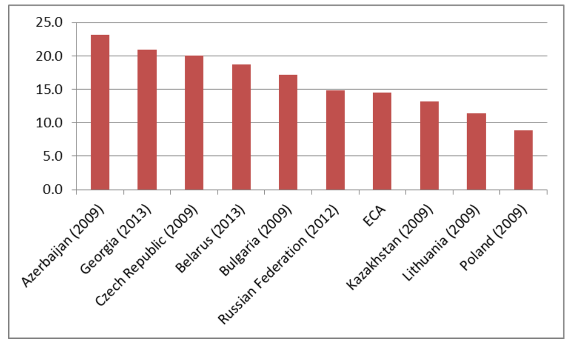
Economy	Year	Percentage of Firms with a Checking or Savings Account	Percentage of Firms with a Bank Loan/LoC
Russia	2012	100.0	21.6
Hungary	2009	97.7	43.0
Bulgaria	2009	96.8	40.2
Poland	2009	95.8	50.1
Georgia	2013	94.2	35.7
Belarus	2013	92.2	30.4

Economy	Year	Percentage of Firms with a Checking or Savings Account	Percentage of Firms with a Bank Loan/LoC
Kazakhstan	2009	92.1	33.2
Europe and Central Asia		88.9	42.5

Source: Enterprise Surveys.

Figure 4.2. Percentage of Firms with Access to Finance Constraints by Firm Size and Regional Comparison



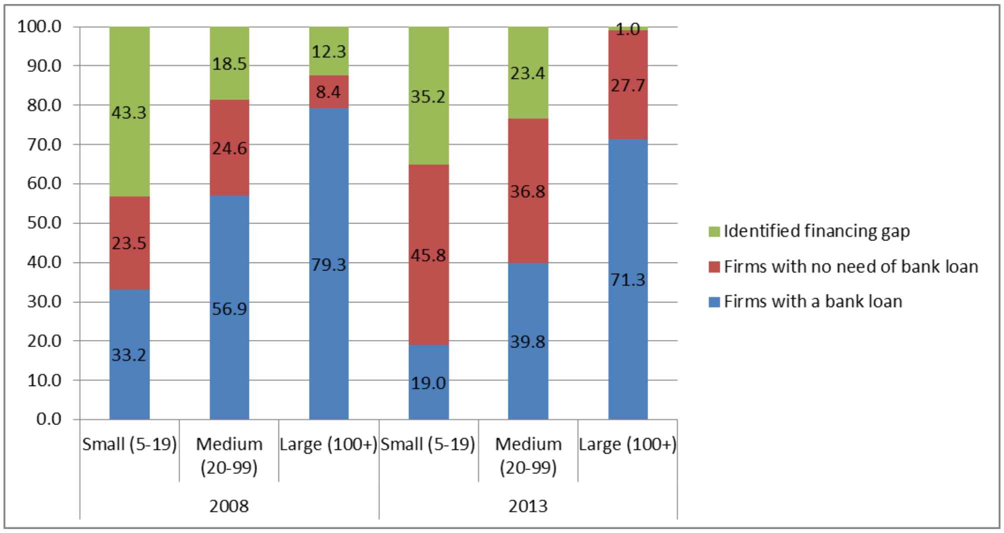


Source: Enterprise Surveys.

7. **Especially MSMEs find it difficult to obtain economically viable financing.** Interest rates in Belarusian rubles remain very high and volatile while banks have rightly tightened their lending in foreign exchange to unhedged firms, given the considerable exchange rate risk. MSMEs are five times more likely to identify access to finance as the biggest obstacle for growth as opposed to only 4 percent of large enterprises (see Figure 4.2). Only 1 percent of large firms surveyed in 2013 mentioned a need for further credit beyond what they currently have compared to 12 percent in 2008 (see Figure 4.3).[8]

Figure 4.3. Financing Gap for Private Sector Enterprises

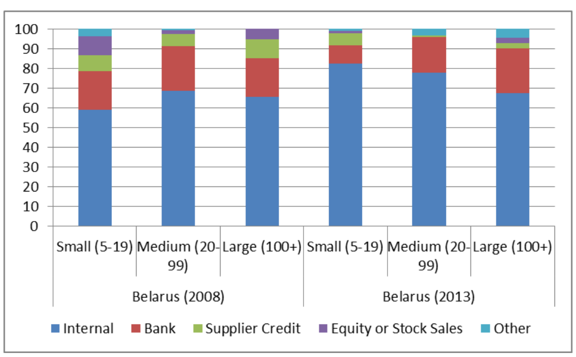
[8] Staff calculations based on World Bank Business Environment Enterprise Surveys.

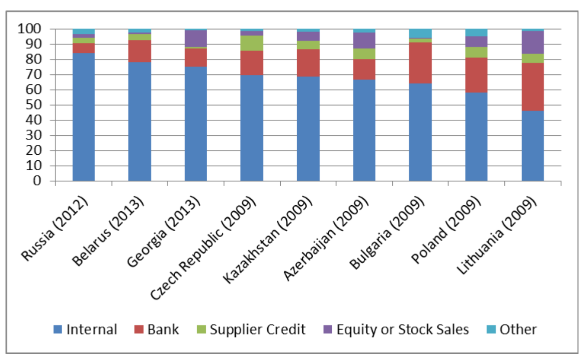


Source: Enterprise Survey, staff calculations.

8. **Even though MSMEs are actively investing in expanding their capacity, their ability to invest and finance their ongoing operations is largely constrained to their own funds.** Compared to 2008, a shift took place toward an increased use of internal resources (78 percent compared to 65 percent in 2008) at the expense of external financing of investments, with only 14 percent financed by banks, 4 percent by supplier credit, and 1 percent by equity or stock sales compared to 21 percent, 8 percent, and 5 percent, respectively, in 2008. Apart from a drop in bank financing that, in particular, affected small companies, MSMEs lost access to alternative financing instruments such as supplier credit and equity or stock sales. Compared to regional peers, Belarus' private sector is characterized by one of the highest dependencies on internal funds while other sources of funding remain below regional average (see Figure 4.4).

Figure 4.4. Investment Financing by Firm Size and Regional Comparison





Source: Enterprise Survey.

9. **Improving the current regime for secured transactions, including the establishment of a collateral registry for movable assets, is also necessary to reduce the cost of credit and ultimately improve access to finance.** A recent survey found that 24 percent of MSMEs that applied for bank loans faced a refusal to accept movable property as loan security. Private enterprises in particular were constrained by banks' reluctance to provide credit using movable collateral. A registration system for movable assets could positively contribute to private sector access to credit, including for MSMEs with limited resources as collateral. Such a registry has

two purposes: (a) to provide notice to third parties of collateral interests in movable property possessed by the debtor and (b) to permit a secured party to establish the priority of its collateral interest. It would also be beneficial to include leasing and factoring transactions in the registry to enhance legal certainty for firms by allowing registration of their ownership of leased assets (such as machinery and equipment) as well as of the receipt and transfer in ownership of accounts receivable to help prevent use of such assets by lessors as collateral on other loans.

DBRB Background

DBRB's Origins and Market Presence

10. **In view of the pervasive and distorting nature of directed lending, the 2009 FSAP recommended establishing an on-budget agency to take over directed lending from state-owned commercial banks.** When set up by the GoB in 2011, DBRB was initially only mandated to channel directed lending. In 2013, its mandate was expanded to include strategic projects, export financing, and leasing finance. DBRB took on the role as coordinator of state-directed lending in 2015 and has recently introduced new financing tools targeted at MSMEs (the latter type of support is provided on a wholesale basis through commercial banks). Going forward, DBRB plans to combine the management of government-directed lending with, increasingly, more traditional development banking functions.

11. **DBRB has grown rapidly since inception.** It has had both organic and nonorganic growth, fueled by the growth of state-directed lending and transfer of government-directed loans from two other state banks. DBRB's total assets grew by 9.3 percent or BYN 451 million in 2016, reaching BYN 5.3 billion or 8.5 percent of market share in total banking sector assets at the end of 2016 (7.6 percent market share at the end of 2015). DBRB became the third largest bank in the system in terms of assets and the second largest in terms of equity and profit in 2016.

Table 4.2. DBRB Balance Sheet, 2016* (BYN, millions)

Assets		Liabilities	
Cash and accounts with the NBRB	66.4	Due to banks	986.1
Due from banks	334.3	Deposits of government bodies	662.5
Investments in securities	1,520.9	Customer accounts	11.5
Loans to customers	3,153.5	Debt securities issued	1,827.6
Other	220.2	Other liabilities	262.6
TOTAL ASSETS	**5,295.2**	**LIABILITIES**	**3,750.2**
		CAPITAL	**1,545.0**

Note: *According to International Financial Reporting Standards.

12. **Given the specific nature of DBRB's operations, its exposures on both assets and liabilities are largely matched in terms of maturities, currencies, and pricing, as specified by the respective decrees of the authorities.** The assets under the assumed loans from other banks are matched by the liabilities in the same currencies and maturities. About 75 percent of DBRB's lending is in local currency, while foreign currency lending is primarily related to export finance operations. By the end of 2016, the bank had short currency positions in Russian rubles and euros. DBRB owns two subsidiaries, including the largest state leasing company in Belarus, Promagroleasing (with numerous subsidiaries and branches) and the consulting company, BR Consult, which acts as an asset management company for the wood processing

industry, with its capacity reinforced by the transfer of DBRB's asset management team to this subsidiary. DBRB is prohibited from lending to its leasing subsidiary.

13. **The DBRB's lending portfolio is currently concentrated in three main sectors, infrastructure (26 percent), industry (24 percent) and agriculture (23 percent).** The remainder is distributed among other sectors, including export financing. In 2015, DBRB launched a new SME finance program that by the end of 2016 had reached BYN 81.9 million disbursements through 12 commercial banks for more than 700 private SMEs. DBRB provides financing on a wholesale basis to other commercial banks for five years at terms lower than the market for smaller and new companies such as private sector SMEs.

DBRB's Financial Standing

14. **DBRB's financial condition is sound and its capital and liquidity positions are adequate.** Its net profit amounted to BYN 111.5 million in 2016. DBRB's capital adequacy ratio as of end-2016 stood at 30.5 percent and return on assets at around 3.2 percent. NPLs totaled 2.3 percent of DBRB's loan portfolio as of January 1, 2017. DBRB has maintained adequate liquidity. It observes minimum liquidity levels prescribed by NBRB prudential regulations for DBRB. It does not take deposits other than the GoB deposits used for directed lending.

15. **The growth in the balance sheet is primarily supported by bond issuances, guaranteed by the Government.** The original sources of financing for DBRB were Government deposits from the MoF, which were linked to the transfer of loans under directed lending programs from the state-owned commercial banks. In addition, in a three-way deal in 2011, DBRB issued bonds to the NBRB for the par value of loans under directed lending programs and received bond issues by the state banks for the full amount of these loans. Hence, the primary source of funding has been bonds issued on the domestic capital market and held by the state-owned commercial banks.

Governance and Risk Management

16. **DBRB's corporate governance structure consists of the general meeting of shareholders, a Supervisory Board, and a Management Board.** The Supervisory Board of DBRB has eight members, of which three are GoB representatives and five are independent members. DBRB is effectively supervised and regulated solely by its own Supervisory Board. Since the bank's operations have fiscal implications and could affect the rest of the banking system, it should be subject to prudential and transparency requirements set by an external supervisor. A respective presidential decree mandating external supervision of DBRB by the NBRB was adopted in May 2016. NBRB has already ceased to be represented on the Supervisory Board, giving up its (small) stake in DBRB would further ensure DBRB's independence.[9]

17. **Effective structures are in place overseeing the bank's risk profile and risk management practices.** In line with good banking practices, DBRB has four committees reporting to the Supervisory Board, including a Risk Committee, Audit Committee, Budget,

[9] Development Module FSAP 2014.

Remuneration, and Appointments Committee, and Strategic Development Committee, which systematically appraise the bank's financial condition, risk profile, and financial and operation risk management practices. The committees are led by non-GoB members of the Supervisory Board. DBRB is organized in a way that is similar to modern banking organizations, using risk analysis models that became prevalent after the introduction of Basel II capital standards. It has established a separate arm that is devoted to risk management. All risk management functions are adequately defined. DBRB has developed and is using well-documented policies and procedures (with written manuals) for management of all types of financial risks (liquidity risk, credit risk, interest rate risk, currency risk, market risk); operational risk; strategy risk; and reputation risk. However, the policies and procedures require further strengthening in line with international best practice and newly applicable NBRB regulations.

Annex 5: Financial Intermediary Assessment

BELARUS: MSME Access to Finance Project (P152276)

1. **An assessment of DBRB took place during project preparation, including OP10 issues, with the confidential report filed internally.** The areas covered included: (a) License and operational history; (b) Ownership and management quality, and organization and institutional capacity fit given the specific risk profile; (c) standing with the supervisory authority; (d) capital adequacy as prescribed by prudential regulations; (e) liquidity adequacy; (f) profitability, risk profile, and value of capital maintenance; (g) policies and written procedures for management of all types of financial risks (liquidity, credit, currency, interest rate, and market risk, as well as risks associated with balance sheet and income statement structures) and operational risk; (h) asset classification, off-balance-sheet credit risk exposures, and provisioning adequacy; portfolio quality adequacy; (i) internal audits and controls adequacy for the specific risk profile; (j) management information systems adequacy. In addition, compliance with the local prudential regulations was assessed.

2. **The assessment was based on:** (a) The externally audited consolidated financial statements by KPMG as of December 31, 2014, and prepared in accordance with IFRS; (b) The unaudited consolidated financial statements as of March 31, 2015; (c) DBRB's Annual Report for 2014; (d) Excerpts from the bank's policies, procedures, methodologies, and other documents; (e) Site visit in May 2015, including interviews with senior management regarding: (i) Organization, ownership and governance structure and business focus; (ii) The bank's financial condition and profitability; (iii) Lending policies, procedures and practices; (iv) Financial risk management, operational risk management; (v) Internal audit function; and (vi) IT systems.

3. **The assessment pointed to eligibility under OP10 and outlined a number of suggestions for reforms.** See Table 5.1 for an overview of the appraisal summary as well as suggested areas for action. To ensure that the bank maintains its operational autonomy and is not misused in certain conflict-of interest situations, the Government's ownership role should be separated from DBRB regulation and supervision while its prudential limits should not be different from those applicable to commercial banks (since resolved through the transfer of external supervisory responsibilities to NBRB). Profitability is satisfactory but will in the future depend on DBRB's capacity to successfully appraise and manage the credit risk. Given that the projects to be funded are mostly long term, possible maturity mismatches need to be avoided and/or very carefully managed. For all new directed lending, DBRB should thoroughly document the credit risk appraisal for each DBRB loan, including appraisal of both project viability and the financial condition of the borrower. The internal audits and control follow-up process needs to be more systematic and supported by on-line access to progress reports. A respective presidential decree mandating external supervision of DBRB by the NBRB was adopted in May 2016. Governance and credit risk management weaknesses are expected to be addressed under the institutional strengthening component of the loan. Close monitoring during supervision will ensure that reforms within DBRB's powers are undertaken in a timely and satisfactory manner.

Table 5.1: DBRB - Appraisal Summary

Criterion	Comments/Actions
Adequate governance, "fit and proper" management	**Generally satisfactory.** Some concerns how to ensure operational autonomy.
Complying to applicable prudential and other regulations	**Generally satisfactory.** Consider imposing the same prudential limits as for banks.
Good business plan	**Satisfactory.**
Effective committees (risk, audit, budget)	**Satisfactory.**
Capital adequacy, positive profitability	**Generally satisfactory.** Profitability critically depends on capacity of DBRB to manage its credit risk.
Liquidity and funding structure	**Generally satisfactory.** Diversification of DBRB funding is of key importance for the next stage of its development.
Policies and Risk Management Functions	**Satisfactory**
Credit portfolio quality, credit risk management	**Generally satisfactory.** For all new directed lending, DBRB should thoroughly document the credit risk appraisal for each DBRB loan, including appraisal of both project viability and financial condition of the borrower.
Internal Audit and Controls	**Generally satisfactory.** Follow-up process needs to be more systematic and supported by on-line access to progress reports.
MIS	**Satisfactory.**